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SENATE

REPORT
No. 97-592

TECHNICAL CORRECTIONS ACT OF 1982

SEPTEMBER 27 (legislative day, September 8), 1982.—Ordered to be printed

Mr. DOLE, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 6056]

The Committee on Finance, to which was referred the bill (H.R. 6056) to make technical corrections related to the Economic Recovery Tax Act of 1981, the Crude Oil Windfall Profit Tax Act of 1980, and the Installment Sales Revision Act of 1980, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

The amendments are shown in the reported bill, with the matter proposed to be stricken in linetype and the matter proposed to be inserted shown in italic type.

I. SUMMARY

In general, the bill contains technical, clerical, conforming, and clarifying amendments to provisions enacted by the Economic Recovery Tax Act of 1981 and certain other tax legislation. These amendments were developed as a result of a review of the application of the statutory changes made by such legislation, taking into account comments submitted to the committee from the Treasury Department, the Internal Revenue Service, the staff, and tax practitioners, and others from the public. The committee approved several amendments on September 24, 1982, as a result of the comments received.

The bill is divided into three general titles. The first title covers amendments to the Economic Recovery Tax Act of 1981. The second title covers amendments to the Crude Oil Windfall Profit Tax Act of 1980, and the third title covers amendments to the In-

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stallment Sales Revision Act of 1980 and certain other tax legislation.

All amendments made by the bill are meant to carry out the intent of the Congress in enacting the original legislation. Therefore, the "Explanation of provision" sections of the report contain no separate "Reasons for change" for each individual amendment.

II. GENERAL EXPLANATION OF PROVISIONS

TITLE I.—TECHNICAL AMENDMENTS TO THE ECONOMIC RECOVERY TAX ACT OF 1981

A. Amendments Relating to Individual Income Tax Provisions

1. Individual rate cuts (sec. 101(a) of the bill and secs. 21 and 6428 of the Code)

Present law

ERTA[1] reduced individual income tax rates in several stages, for a total reduction of approximately 23 percent. For 1981, the rates were reduced 1¼ percent. The 1981 reduction was achieved by the use of a credit, rather than a reduction in the rate schedules. The individual rate changes made by ERTA are not prorated in the case of fiscal year taxpayers.

Explanation of provision

The bill clarifies that fiscal-year individuals and other non-corporate fiscal-year taxpayers will use the 1981 rate schedules for fiscal year 1981–1982 (i.e., they will not prorate with the 1982 rate schedules). They will be entitled to the 1¼ percent credit on their tax liability for their 1981–1982 fiscal year.[2]

The bill also clarifies that the 1¼ percent credit for 1981 is not available to reduce the portion of an individual's tax determined under the 50-percent maximum rate for personal service income (sec. 1348) or the special 20-percent capital gains rate for post-June 9, 1981, gains, but is available to reduce the tax on lump-sum distributions under sec. 402(e).

Also, the bill corrects certain 50-cent rounding errors in the tax schedules for married taxpayers filing separate returns, estates, and trusts. Thus, for example, the tax on a married person filing a separate return using the rate schedule will be exactly one-half the amount which would be computed under the married filing joint return schedule if such person's taxable income were multiplied by two. The tax on an estate or trust will be the same as if the estate or trust were a married individual filing a separate return using the rate schedule and such estate or trust's taxable income were increased by $1,700 (the zero bracket amount for a married individual filing a separate return).

Effective date

The provisions are effective as if originally included in ERTA.

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[1] The Economic Recovery Tax Act of 1981 (P.L. 97-34).

[2] Treasury regulations allow a taxpayer to change to a calendar year accounting period in order to benefit from the lower tax rates adopted by ERTA. Reg. § 5c. 442-1.

2. Foreign earned income exclusion (sec. 101(c) of the bill and sec. 911 of the Code)

Present law

ERTA replaced the system of deductions and exclusions for the excess costs of living abroad with an exclusion for income earned abroad of up to $75,000 in 1982, increasing in annual increments of $5,000 up to $95,000 in 1986 and later years. In addition, an exclusion or deduction for certain foreign housing costs is provided.

Explanation of provision

The bill clarifies that the amount of the foreign earned income exclusion (including the exclusion for housing) plus the deduction for housing expenses cannot exceed the taxpayer's foreign earned income for the year.

Effective date

The provision applies to taxable years beginning after December 31, 1981.

3. Gain on sale of residence (sec. 101(d) of the bill and sec. 1034 of the Code)

Present law

Gain on the sale of a taxpayer's principal residence may be "rolled over" tax-free if a new principal residence is purchased within the replacement period. ERTA extended the replacement period from 18 months to 2 years. In addition, only one tax-free rollover is allowed every 2 years; this period also was increased from 18 months by ERTA. The effective date of this provision was generally for sales made after July 20, 1981. However, the changes were also effective for sales made on or before July 20, 1981, if the prior law 18-month rollover period had not expired by July 20, 1981. The result of these changes could deny tax-free rollover treatment in certain situations involving two sales more than 18 months, but less than two years, apart.

Explanation of provision

Under the bill, a taxpayer selling a principal residence before August 14, 1981, may elect not to have the rollover amendments made by ERTA apply to the sale. This will protect a taxpayer who had previously sold a residence within two years from losing any otherwise applicable tax-free rollover benefit.

Effective date

The provision applies to old residences sold or exchanged on or before August 13, 1981.

4. Dependent care assistance exclusion (sec. 101(e) of the bill and sec. 129 of the Code)

Present law

ERTA provided an exclusion from an employee's gross income (within certain limits) for amounts paid or incurred by an employer

for dependent care assistance provided to an employee under a dependent care assistance program which meets certain conditions.

Explanation of provision

The bill provides that in order to be qualified, a dependent care assistance program cannot provide benefits that discriminate in favor of officers, owners, or highly compensated employees, or their dependents.

Also, the bill clarifies that an employer is not disallowed a tax deduction for amounts employees exclude from income.[3]

Effective date

The provision applies to taxable years beginning after December 31, 1981.

5. Adoption expenses (sec. 101(f) of the bill and sec. 222 of the Code)

Present law

ERTA provided a new itemized deduction (up to $1,500) for qualified adoption expenses paid or incurred to adopt a child with special needs.

Explanation of provision

The bill clarifies that the deduction is available for the adoption of a child who the State determines is a child with special needs, as defined for purposes of the Social Security Act adoption assistance program. This is a child who the State determines cannot or should not be returned to his or her parental home, who has a specific factor or condition which makes the child difficult to place, and who has been the subject of an unsuccessful placement effort.

Effective date

The provision applies to taxable years beginning after December 31, 1980.

6. Clerical amendments to the individual income tax provisions

a. A reference in section 402(e) to the zero bracket amount is corrected.

b. Code section 483(g)(4) is amended by correcting a reference to paragraph (g)(1).

[3] Sec. 127 (relating to educational assistance programs) contains a rule disallowing deductions and credits for amounts excluded from income. The IRS has issued proposed regulations interpreting that rule as not applying to the employer.

B. Amendments Relating to Business Incentive Provisions

1. Accelerated cost recovery system (sec. 102(a) of the bill and secs. 168, 751, and 1250 of the Code)

Present law

ERTA replaced the prior law depreciation system with a new mandatory cost recovery system under which eligible property is recovered over a period of 3, 5, 10, or 15 years. Longer periods may be elected.

Explanation of provision

The bill makes a number of clarifying amendments to the ACRS provisions.

The bill clarifies that recovery allowances for 15-year real property for the year the property is placed in service or disposed of will be based on the number of months the property is in service during the year regardless of the length of the taxpayer's taxable year, and regardless of the recovery period and method used by the taxpayer.

The bill allows the Treasury Department to prescribe rules relating to the treatment of recovery allowances where property is transferred in certain related party transfers, sale-leasebacks, and tax-free transfers (to which sec. 168(f)(10) applies).

The bill allows the Treasury Department to prescribe rules to determine recovery allowances where the use of the property changes, such as from domestic use to foreign use.

The bill clarifies that qualified coal utilization property in the 10-year recovery class means only property which otherwise would be 15-year public utility property.

The bill clarifies that a partner's gain on sale of a partnership interest will be ordinary income to the extent that the partnership would have realized ordinary income if it disposed of its "section 1245 recovery property" in the year the partner sold its interest.

The bill clarifies that straight-line depreciation, for purposes of determining recapture under section 1250 on 15-year real property, will be based on straight-line depreciation over the recovery period used by the taxpayer with respect to the particular property.

The bill provides that a building, and its structural components, shall not be treated as 10-year property by reason of a change in use after the property was originally placed in service (by any person). Thus, a building which is converted to a theme-park structure will remain 15-year property, and may be eligible for the rehabilitation credit.

The bill clarifies that the anti-churning rules of ACRS will not apply to property transferrd by reason of the death of a taxpayer or to property transferred by reason of the acquisition of more than 90 percent of partnership interests by parties unrelated to the selling partners.

The bill allows the Treasury Department to prescribe rules imposing normalization requirements with respect to public utility property that is subject to a safe harbor lease under section 168(f)(8).

The bill also allows the Treasury Department to prescribe rules under which section 1245 property transferred incidental to the transfer of section 1250 property will be subject to the anti-churning rules that apply to section 1250 property. For example, in the case of a transfer of a furnished apartment building, the anti-churning rules for section 1250 property will apply to building furnishings that are section 1245 property. However, this rule does not apply where section 1245 property represents a significant portion of the property transferred, such as where machinery or equipment in a manufacturing plant are transferred together with section 1250 property.

The House bill did not contain the preceding three provisions.

Effective date

The provision applies to recovery property placed in service after December 31, 1980.

2. Minimum tax preferences (sec. 102(b) of the bill and secs. 57–58 of the Code)

Present law

Under ERTA, as under prior law, accelerated recovery on personal property leased by individuals and accelerated recovery on real estate are items of tax preferences for purposes of the minimum tax (and for 1981, the maximum tax on personal service income).

Explanation of provision

The bill clarifies that the tax preference for accelerated recovery deductions on real estate continues to apply to corporations (including REITs) as under prior law. The bill also clarifies that accelerated deductions for 5-year amortization of low-income housing (under sec. 167(k)) remain a tax preference.

The bill clarifies that the minimum tax is inapplicable where property is recovered over a period longer than the period prescribed under the minimum tax provisions.

Effective date

The provision applies to recovery property placed in service after December 31, 1980.

3. Earnings and profits (sec. 1021(c) of the bill and sec. 562 of the Code)

Present law

Under the accelerated cost recovery system, the cost of real property generally is recovered over a 15-year period. However, the recovery period for real property for purposes of determining the earnings and profits of a corporation is 35 years. Because of the difference in recovery periods, the amount of gain from the sale or other disposition of real property can cause the taxable income for the year to be greater than the amount of current or accumulated earnings and profits for the year in which the real property is sold or disposed of.

Under present law, in order to qualify as a real estate investment trust, the dividends paid during the taxable year generally must be at least 95 percent of the real estate investment trust taxable income. In addition, a real estate investment trust is allowed a deduction for distributions to its shareholders only if those distributions are treated as dividends. Where the amount of taxable gain from the sale or disposition of real property is greater than the current or accumulated earnings and profits because of the different recovery periods used for computing taxable income and earnings and profits, the real estate investment trust may not have sufficient earnings and profits to pay enough dividends to meet the 95-percent test or to avoid taxation of all income from the sale or other disposition of the real property through dividend distributions to its shareholders.

Explanation of provision

The bill provides that, for purposes of determining the amount of dividends paid by a real estate investment trust, the earnings and profits for the year are computed by including the full amount of gain from the sale or other disposition of real property (i.e., the basis is computed using the 15-year recovery period). The House bill did not contain this provision.

Effective date

The provision applies to recovery property placed in service after December 31, 1980.

4. Carryovers (sec. 102(d) of the bill and sec. 172 of the Code)

Present law

Generally, ERTA extended the carryover period for net operating loss carryovers and credit carryovers to 15 years.

Explanation of provision

The bill clarifies that the NOL carryover period for all unexpired NOL carryovers to 1981 of former REITs would be 15 years.

The bill clarifies that NOL or credit carryovers which expired prior to 1981 are not revived by ERTA.

Effective date

The provision applies to carryovers to taxable years ending after December 31, 1980.

5. Investment tax credit (section 102(e) of the bill and secs. 46–48 of the Code)

Present law

Under ERTA, three-year class property is eligible for a 6-percent investment tax credit, and other property is eligible for a 10-percent credit. Additional credits continue to apply to energy property, and additional credits were made applicable to certain rehabilitation expenditures for buildings. ERTA also extended the investment tax credits to certain storage facilities used in connection with the distribution of petroleum products.

Explanation of provision

The bill clarifies that eligible 15-year real property, such as elevators and escalators, is entitled to full investment credits.

The bill clarifies that a building or structural component (such as a warehouse) used as a storage facility in connection with the distribution of petroleum products is not eligible for the investment credit, is treated as 15-year real property under ACRS, and is not automatically subject to section 1245 recapture.

Effective date

The provision applies to recovery property placed in service after December 31, 1980.

6. Rehabilitation expenditures (sec. 102(f) of the bill and secs. 46(a) and 48(g) of the Code)

Present law

ERTA provided a 15-percent investment tax credit for the rehabilitation of qualified nonresidential buildings at least 30 years old, a 20-percent credit for qualified nonresidential buildings at least 40 years old, and a 25-percent credit for certified historic buildings. A qualified rehabilitated building is a building which (1) has been substantially rehabilitated, (2) was placed in service before the beginning of rehabilitation, and (3) retains 75 percent or more of the existing external walls as such following completion of rehabilitation.

In general, to be substantial, the rehabilitation expenditures during a 24-month period generally must exceed the greater of $5,000 or the adjusted basis of the property. The adjusted basis of the property for this purpose is determined as of the beginning of the 24-month period or the beginning of the holding period of the property (within the meaning of sec. 1250(e)). The 15-percent and 20-percent credits require an adjustment to the building's basis; the 25-percent credit does not. Under subsequent legislation (Tax Equity and Fiscal Responsibility Act of 1982), however, taxpayers will be required to reduce the basis of a certified historic structure by 50 percent of the rehabilitation credit, generally, for property placed in service after December 31, 1982.

Qualified rehabilitation expenditures do not include expenditures for rehabilitation of a building in an historic district that is not a certified historic structure unless the taxpayer obtains a certificate from the Interior Department that the building is not of historic significance to the district. If the building is determined to be a certified historic structure, no credit is allowed if the rehabilitation is not certified by the Interior Department as being consistent with the historic character of the building.

To obtain the credit under ERTA, the taxpayer must elect the straight-line method for the rehabilitation expenditures. To elect straight-line for improvements under ACRS, the taxpayer must have elected straight-line for the building shell, unless the rehabilitation occurs more than 3 years after the property is placed in service by the taxpayer.

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The provision (sec. 191) previously permitting 5-year amortization of the costs of rehabilitating certified historic structures was repealed.

Explanation of provision

The bill clarifies that a building on which a rehabilitation began before 1982 and which is not eligible for the new investment credit will not lose its eligibility for 5-year amortization (under sec. 191), whether or not the rehabilitation was eligible for the prior law investment credit.

The bill clarifies that for purposes of determining whether the rehabilitation expenditures exceed the adjusted basis of the property at the beginning of the holding period (where the property has been held for less than 24 months), the beginning of the holding period will be determined without regard to reconstruction by the taxpayer that is a part of the rehabilitation. The House bill did not contain this provision.

The bill clarifies that the end of the 24-month period (or 60-month period, in the case of certain phased projects) with respect to which the substantiality of a rehabilitation project is measured may be set at any time during the taxable year in which the credit is claimed, rather than only on the last day of that taxable year.

The bill clarifies that a rehabilitation will not be made ineligible for the 10-percent credit in effect for rehabilitations begun before 1982 solely because the taxpayer's building was designed as a certified historic structure in response to a request filed after December 31, 1981 and before September 27, 1982, by the taxpayer (with the Interior Department) for a determination of whether the building is of historic significance to the district. The House bill did not contain this provision.

The bill clarifies that a basis adjustment for any allowable investment credit would be required for certain rehabilitation regardless of whether the credit is used or carried forward.

The bill clarifies that taxpayers may elect the straight-line method for the building shell at any time within 3 years after the shell is placed in service by the taxpayer. This will enable taxpayers to elect the straight-line method for the rehabilitated portion of the building, and thus claim the credit. Such an election will require retroactive adjustments in the cost recovery allowances previously claimed by the taxpayer on the building.

The bill clarifies that only a qualified rehabilitated building is eligible for any of the rehabilitation credits.

The bill clarifies that the basis of land is not taken into account in measuring whether a rehabilitation is substantial.

Effective date

The provision applies as if it had been included in the provision of ERTA to which it relates.

7. Investment tax credit for used property (sec. 102(g) of the bill and sec. 48(c) of the Code)

Present law

ERTA increased the used property limitation from $100,000 to $150,000 ($125,000 in taxable years beginning in 1981, 1982, 1983, and 1984).

Explanation of provision

The bill clarifies that the increased used property limitation for the investment credit applies only to taxable years beginning after 1980.

Effective date

The provision applies to taxable years beginning after December 31, 1980.

8. Credit for increasing research expenditures (sec. 102(h) of the bill and sec. 44F of the Code)

Present law

ERTA added a 25-percent income tax credit based on the amount by which a taxpayer's qualified research expenditures for the taxable year exceed the average qualified research expenditures in a base period (generally, the preceding three taxable years). Qualified research expenses include "in-house research expenses" and "contract research expenses". The first category consists of amounts paid or incurred for certain research wages, research supplies, or the right to use personal property in research.

Explanation of provision

The bill provides that in-house research expenses do not include amounts paid or incurred after March 31, 1982, for the right to use personal property in research, to the extent the taxpayer receives or accrues payments for the right to use substantially identical personal property.

The bill adds the research credit to the list of income tax credits which may be reduced under Code section 108(b)(2) when a taxpayer has income from discharge of indebtedness excluded from gross income by reason of bankruptcy or insolvency.

Effective date

The provision applicable to certain research expenditures applies to amounts paid or incurred after March 31, 1982.

The provision relating to section 108 applies to credits earned after June 30, 1981.

9. Qualified subchapter S trusts (sec. 102(i) of the bill and sec. 1371(g) of the Code)

The provisions of subchapter S allow certain closely held corporations to have their income and losses taxed directly to the shareholders. Prior to ERTA, trusts other than grantor trusts, voting trusts, and certain testamentary trusts could not be shareholders in a subchapter S corporation. ERTA amended the code to allow

certain trusts which distribute all their income currently to the sole income beneficiary to be a shareholder in a subchapter S corporation.

Explanation of provision

The provision clarifies that a trust required to distribute all its income currently to a sole income beneficiary (i.e., a "simple" trust), as well as a trust which actually does distribute all its income currently to a sole income beneficiary, may qualify to be a shareholder in a subchapter S corporation. Also, the bill clarifies that the distribution requirement applies with respect to income within the meaning of section 643(b), i.e., the local law definition of income.

The bill adds a cross-reference in section 678 to the qualified subchapter S trust provisions.

Effective date

The provisions apply to taxable years beginning after December 31, 1981.

10. Incentive stock options (sec. 102(j) of the bill and sec. 422A of the Code)

Present law

ERTA added provisions to allow all income with respect to certain employee stock options ("incentive stock options") to be taxed at capital gains rates when the stock received on the exercise of the option is sold. The amount of stock with respect to which incentive stock options may be granted in any year after 1980 is limited to $100,000 (determined at the time of grant) plus a partial carryover of any previously unused amount.

Explanation of provision

The bill clarifies that if the option stock is sold or exchanged in a recognition transaction prior to the end of the required holding period (two years from the grant of the option and one year from the exercise), the amount of ordinary income to be recognized is limited to the excess of the amount realized over the adjusted basis of the stock.

The bill clarifies that the dollar limit (under sec. 422A(b)(8)) with respect to options which may be granted in any year applies only to incentive stock options and that the limit is not affected by nonqualified options.

The bill allows a good faith valuation to be used in applying the maximum dollar limit and the carryover of any unused limit, under regulations prescribed by the Treasury.

The bill provides that an employee's transfer of stock acquired pursuant to the exercise of a statutory stock option to acquire other stock in connection with the exercise of an incentive stock option will be treated as a recognition transaction if the transferred stock has not met the minimum statutory holding period to receive special tax treatment (under sec. 421(a)). Thus, such a disposition will result in ordinary income treatment (under section

421(b)) with respect to the stock disposed of, but will not affect the favorable tax treatment for the stock received.

Effective date

The provisions generally apply with respect to incentive stock options granted on or after January 1, 1976, and exercised after 1980. The provision relating to taxable dispositions applies to dispositions made after March 15, 1982.

11. Restricted property (sec. 101(k) of the bill and sec. 83(c) of the Code)

Present law

ERTA provided that if stock received by a taxpayer is subject to the "insider" trading restriction of section 16(b) of the Securities Exchange Act of 1934, the time the income with respect to that stock is taken into account under section 83 is postponed.

Explanation of provision

The bill clarifies that the new rules apply to transfers after December 31, 1981, without regard to the recipient's taxable year.

The bill corrects the name of the Securities Exchange Act of 1934 as referred to in the Code.

Effective date

The provision applies to transfers after December 31, 1981.

12. Targeted jobs credit (sec. 102(l) of the bill and sec. 51 of the Code)

Present law

ERTA extended the targeted jobs credit through 1982, revised the definition of certain eligible target groups, changed the certification rules, and made other technical changes.

Explanation of provision

The bill clarifies that wages paid to cooperative education students will continue to be eligible wages even if the income of the student's family increased after the initial determination that the family was economically disadvantaged.

The bill clarifies that the WIN credit is not available for amounts paid to any employee in taxable years beginning after December 31, 1981.

The bill clarifies that individuals participating in work incentive demonstration programs authorized under P.L. 97-35 could be members of a targeted group.

The bill provides that the 6-month period for which the determination of an individual's eligibility as a member of an economically disadvantaged family is made will end at the earlier of the month in which the determination is made or the month in which the individual is hired. The House bill did not contain this provision.

Effective date

The provision generally applies as if included in ERTA. The provision relating to the income determination period will apply with respect to individuals who begin work after May 11, 1982, with respect to certifications issued after the date of enactment of this bill.

13. Increase in deduction for charitable contributions by corporations (sec. 102(m) of the bill and sec. 170 of the Code)

Present law

ERTA increased the charitable deduction limit for corporations from 5 percent to 10 percent of the corporation's taxable income (computed with certain adjustments).

Explanation of provision

The bill conforms several provisions of the Code, including provisions relating to insurance companies and tax-exempt organizations, to reflect the limit increase from 5 percent to 10 percent made by ERTA.

Effective date

The provision applies to taxable years beginning after December 31, 1981.

14. Motor carrier operating authorities (sec. 102(n) of the bill and section 266 of ERTA)

Present law

ERTA allowed taxpayers holding motor carrier operating authorities on July 1, 1980, to deduct the basis of the authorities over a 60-month period.

Explanation of provision

The bill clarifies that motor carrier amortization deductions may carry over in corporate acquisitions to which section 381 applies.

Effective date

The provision would be effective on the date of enactment of the bill.

15. Clerical amendments to the business incentive provisions

a. Code section 1248(c) is amended by correcting a cross reference to section 312(k)(4).

b. A reference in section 207(c)(2) of ERTA is corrected.

c. A cross reference at Code section 425(j) is amended by adding a reference to incentive stock options.

d. The bill corrects a reference in Code section 47 to Code section 46(c)(8)(F).

C. Amendments Relating to Savings Provisions

1. Qualified tax-exempt savings certificates (sec. 103(a) of the bill and sec. 128 of the Code)

Present law

ERTA provides a lifetime exclusion of $1,000 ($2,000 in the case of a joint return) of interest earned on qualified tax-exempt savings certificates. In general, institutions which are eligible to issue qualified tax-exempt savings certificates must have their deposits or accounts insured under Federal or State law or are protected or guaranteed under State law. In addition, eligible issuers cannot be a foreign branch or international banking facility.

Explanation of provision

The bill clarifies that the special limit (under sec. 128(d)(4)) used to determine the amount of tax-exempt certificates which a credit union may issue is applied by taking into account amounts deposited in credit union share accounts.

The bill also corrects references in sections 584, 643, and 702 to section 128.

The bill provides an additional class of eligible issuers of qualified tax-exempt savings certificates for certain military banking facility located on a United States military installation located outside the United States. The House bill did not contain this provision.

Effective date

The provision generally applies to taxable years ending after September 31, 1981.

2. Net interest exclusion (sec. 103(b) of the bill and sec. 128 of the Code)

Present law

ERTA provides an exclusion of 15 percent, up to $3,000, of net interest ($6,000 on a joint return) starting in 1985.

Explanation of provision

The bill clarifies that an individual who does not itemize deductions will not be required to reduce interest income eligible for the net interest exclusion by interest expense, and that a person itemizing deductions will be required to reduce such interest income by no more than the amount of his or her excess itemized deductions. The bill also provides that adjusted gross income will not be reduced by the amount of the net interest exclusion, for the purposes of determining the amount of exclusions, itemized deductions, and credits.

Effective date

The provision applies to taxable years beginning after December 31, 1984.

3. Individual retirement savings (sec. 103(c) of the bill and secs. 72, 219, 402, 403, 2039, and 4972 of the Code)

Present law

ERTA generally allows individuals an annual deduction for contributions to an individual retirement account, annuity, or bond (IRA) limited to the lesser of $2,000 ($2,250 for a spousal IRA) or 100 percent of compensation. In lieu of the deduction for IRA contributions, an employee is allowed a deduction (subject to the IRA limit) for qualified voluntary employee contributions to an employer's retirement plan. Accumulated deductible employee contributions under an employer's plan generally are subject to IRA-type rules.

Explanation of provision

The bill clarifies the rules for spousal IRAs to insure that an employee is not denied a deduction for contributions to an IRA for the benefit of a spouse having no compensation merely because the employee is also allowed a deduction for employer contributions to an IRA which qualifies as a simplified employee pension (SEP). In addition, the bill makes it clear that a deduction is allowable for IRA contributions for the benefit of a spouse who has not compensation and who has not attained age 70½ before the close of the taxable year, even if the spouse having compensation is age 70½ or older.

The bill deletes simplified employee pension from the definition of qualified employer plan. (Except for the limit on contributions, SEPs are generally subject to the tax rules applicable to IRAs.)

The bill clarifies the rules allowing a deduction for individual retirement savings by providing that, for a self-employed individual compensation includes net earnings from self-employment reduced by any amount allowable as a deduction to the individual for contributions made on behalf of the individual to a tax-qualified plan (an "H.R. 10" plan or "Keogh" plan). In addition, the bill clarifies that compensation, for this purpose, does not include pension and annuity payments or other deferred compensation.

The bill clarifies the rule allowing a deduction for certain voluntary employee contributions made to a qualified employer or government plan after the close of the taxable year by providing that such contributions must be made on account of that taxable year.

The bill clarifies that a 10-percent additional income tax is imposed on early withdrawals (generally, before age 59½) of accumulated deductible employee contributions from either the plan to which the contributions were made or from a plan to which the accumulated contributions were rolled over or otherwise transferred.

The bill revises the rules relating to lump-sum distributions and rollover amounts under qualified plans and tax-sheltered annuity programs to clarify that partial (as well as total) distributions of accumulated deductible employee contributions are eligible for tax-free rollover treatment.

The bill clarifies that accumulated deductible employee contributions payable to a beneficiary of a deceased employee under a tax-qualified plan are eligible for the estate tax exclusion only if any lump-sum distribution also payable to the beneficiary under the plan is eligible for the exclusion.

The bill clarifies that an owner-employee (a sole proprietor, or a partner whose partnership interest exceeds 10 percent) is permitted to make deductible employee contributions to a tax-qualified plan (an "H.R. 10" plan or "Keogh" plan) notwithstanding the rules which may preclude nondeductible employee contributions by the owner-employee.

The bill clarifies effective date provisions for the estate and gift tax provisions relating to individual retirement savings.

Effective date

The provisions apply to taxable years beginning after December 31, 1981.

4. Retirement plan deduction for self-employed individuals (sec. 103(d) of the bill and secs. 401 and 408 of the Code)

Present law

ERTA increased from $7,500 to $15,000, the maximum annual deduction limit for employer contributions to defined contribution H.R. 10 plans, defined contribution plans maintained by subchapter S corporations, and simplified employee pensions (SEPs). Conforming changes were made to the limits on benefit accruals in defined benefit H.R. 10 plans. In addition, ERTA permitted a plan to increase from $100,000 to $200,000 the amount of compensation taken into account if the plan provides specified minimum contributions or benefits for common law employees.

Explanation of provision

The bill amends the minimum contribution rule applicable to simplified employee pensions to permit the exclusion of self-employed individuals. This change conforms the minimum contribution rule for SEPs to that for H.R. 10 plans and plans maintained by subchapter S corporations.

The bill increases the limit on contributions to an IRA to which an employer makes contributions under a SEP from $15,000 to $17,000, to allow the IRA to accept employee contributions of $2,000 in addition to employer contributions of $15,000.

The bill clarifies the effective date provision to apply to all plans, whether or not they cover a self-employed individual.

Effective date

The provisions apply to taxable years beginning after December 31, 1981.

5. Public utility dividend reinvestment plans (sec. 103(f) of the bill and sec. 305(e) of the Code)

Present law

ERTA added a provision which allows public utility corporations to set up dividend reinvestment plans under which shareholders electing to receive distributions in the form of common stock, rather than money or other property, may exclude from income up to $750 per year ($1,500 in the case of a joint return) of the stock distribution.

Explanation of provision

The bill clarifies that a corporation is a qualified public utility, if during the 10 years prior to its taxable year in which the distribution is paid, at least 60 percent of the cost of all tangible property described in subparagraphs (A) and (B) of section 1245(a)(3) (i.e., personal property and certain other tangible property) placed in service (whether or not purchased or self-constructed) by the corporation during the 10-year period was qualified long-life public utility property. Qualified long-life public utility property means any tangible property described in subparagraph (A) or (B) of section 1245(a)(3), which has a present class life of more than 18 years and which is public utility property (as defined in section 167(1)(3)(A)). Thus, property excluded from the definition of recovery property under ACRS may nevertheless meet the definition of qualifed long-life public utility property.

Effective date

The provision applies to distributions made after 1981 and before 1986.

6. Employee stock ownership plans (secs. 103 (g), (h), and (i) of the bill and secs. 44G, 401, and 409A of the Code)

Present law

Under ERTA, the additional investment tax credit allowed an employer for contributions to an employee stock ownership plan (ESOP) is terminated with respect to qualifying investments made after December 31, 1982. For taxable years ending after that date, an electing employer is allowed an income tax credit for ESOP contributions limited to a prescribed percentage of the aggregate compensation of all employees covered by the plan.

Explanation of provision

The bill adds provisions relating to regulated public utilities which conform the rules for the payroll-based tax credit for ESOP contributions to the rules for the investment-based tax credit for ESOP contributions. These rules limit the normalization requirements to compensation paid which is subject to ratemaking.

The bill clarifies that the tax-qualified status of an ESOP is not affected merely because employer contributions are determined solely by reference to the payroll-based tax credit allowable to the employer for the contributions.

The bill clarifies that certain cash distribution provisions, if provided under a tax credit ESOP of an employer whose stock generally is required to be held only by employees, will not affect the plan's status either under the qualified plan rules or those additional rules applicable to tax credit ESOPs.

The bill clarifies the rules permitting a distribution to a participant under a tax credit ESOP in the event of the participant's transfer from one employer to another incident to a sale of assets by the former employer to the new employer.

Effective date

The provisions generally apply to compensation paid or accrued after December 31, 1982.

7. Clerical amendments to savings provisions

a. A parenthesis is added to Code section 219(b)(2)(A).

b. Code sections 3401(a)(12) and 6047(d) are amended to reference section 219.

c. Subsections (m) and (n) of Code section 408 are redesignated as (l) and (m).

d. The bill deletes a redundant reference in the alternative minimum tax to the ESOP credit.

e. the bill corrects a reference in Code section 402(e)(4)(J) to section 72.

f. The bill corrects a reference in section 331(c)(4) of ERTA.

D. Amendments Relating to Estate and Gift Tax Provisions

1. Unlimited marital deduction (sec. 104(a) of the bill and secs. 1014, 2044, 2056, 2519, and 2523 of the Code)

Present law

ERTA removed the quantitative limits on the marital deduction for both estate and gift tax purposes. Thus, unlimited amounts of property (other than certain terminable interests) may be transferred between spouses without estate or gift tax.

Under the Act, certain transfers of qualified terminable interest property qualify for the marital deduction. If certain conditions are met, a surviving spouse's income interest in qualified terminable interest property is not treated as a terminable interest. The entire property subject to such interest is treated as passing to the spouse and no interest in such property is considered to pass to any other person. Accordingly, the entire property qualifies for a marital deduction.

The Act also provided that the entire value of property subject to an election to be treated as a qualified terminable interest will be subject to transfer taxes at the earlier of (1) the date on which the donee spouse disposes (either by gift, sale, or otherwise) of all, or any part, of the qualifying income interest or (2) upon the donee spouse's death.

In addition, in the case of property that is owned by the decedent and included in the decedent's gross estate for estate tax purposes, the basis of that property in the hands of the estate, heir, or other recipient of the property generally is "stepped up" to its fair market value on the date of the decedent's death (or alternative valuation date if that date is elected for estate tax purposes).

Explanation of provisions

The bill clarifies that qualified terminable interest property ("QTIP property") included in the estate of a deceased donee-spouse (under sec. 2044) is eligible for a "step-up" in basis.

The bill clarifies that QTIP property included in a deceased donee spouse's estate is treated as passing from that spouse, for purposes of the estate tax, including the charitable and marital deductions. In the case of a transfer to a pooled income fund (as defined in section 642(c)(5)) in which the spouse of the transferor is the sole life beneficiary of certain units of participation in the fund, a marital deduction may be allowed for the entire value of the transfer with respect to such units if the property qualifies as QTIP property and the election is made. For example, where property is transferred to a pooled income fund in which the surviving spouse is given all or a specific portion of the income for her life from some or all of the units of participation attributable to the transfer to the fund, the surviving spouse's interest may qualify as a "qualifying income interest for life" regardless of whether a person other than the spouse (e.g., a charity) receives the income from other units of participation attributable to the transfer to the fund. In determining whether such property qualifies as QTIP property, the fact that the income payments terminate on the last required regular payment date before the death of the beneficiary

spouse, shall not cause the spouse's interest to fail to be a qualified income interest.

The bill clarifies that the special rule, providing for a constructive gift as a result of a lifetime transfer by the donee spouse of an income interest in QTIP property, applies only to the remainder interest in QTIP property. The tax treatment of the life estate in QTIP property is governed by the rules generally applicable to any life estate held by the surviving spouse.

The bill clarifies that the lifetime QTIP election must be made no later than April 15 of the calendar year following the year the gift is made (i.e., the due date of the annual gift tax return).

The bill clarifies that a transfer by the donor spouse of any retained interest in QTIP property after the transfer of the life interest to the donee spouse is not treated as a transfer for estate and gift tax purposes. This rule will not apply after the earlier of a subsequent disposition by the donee spouse or the death of the donee spouse.

The bill clarifies that an annuity does not qualify as a qualifying income interest.

Effective date

The provisions apply with respect to estates of decedents dying after December 31, 1981, and gifts made after that date.

2. Current use valuation (sec. 104(b) of the bill and sec. 2032A of the Code)

Present law

If certain requirements are satisfied, an executor of an estate comprised largely of real property used in farming or other closely held businesses may elect to value the property at its current use value, rather than at its full fair market value. If, within a prescribed period after the death of the decedent (and before the death of the qualified heir), specially valued property is disposed of to nonfamily members or ceases to be used for the farming or other closely held business purpose on the basis of which it was valued in the decedent's estate, all, or a portion of, the Federal estate tax benefits obtained by virtue of the reduced valuation are recaptured by means of a special "additional estate tax" or "recapture tax" imposed on the qualified heir.

Material participation

The provision, as amended by ERTA, required that the decedent or a member of the decedent's family materially participate in the business operation for periods aggregating five years of the eight-year period ending on the earliest of (1) the decedent's death, (2) the beginning of continuous disability lasting until death, or (3) retirement lasting until death, if the estate is to receive the benefits of current use valuation. ERTA also amended the provision to deem the material participation requirement to be satisfied for specially valuing property in the estate of a surviving spouse of a decedent whose estate was eligible to value the property based upon its current use if the spouse engages in "active management" of the business operation. Active management means the making of busi-

ness decisions other than daily operating decisions, and requires a lesser standard of involvement than material participation.

Retroactive application

Four changes made by ERTA apply retroactively to certain estates of decedents dying after December 31, 1976, as well as prospectively. These four changes apply retroactively to (1) estates of decedents for which the estate tax return was due and timely filed on or before July 28, 1980 (the date on which the final Treasury regulations under section 2032A were adopted), provided that the estate timely elected current use valuation on the decedent's estate tax return (even if the election was subsequently revoked), and (2) estates of decedents for which an estate tax return was due and timely filed after July 27, 1980, whether or not the estate originally elected the current use valuation provision.

Estates which were eligible to reinstate (or make) elections because of these retroactive changes were required to do so on or before the date which was six months after the date of enactment of ERTA.

Explanation of provisions

The bill allows "tacking" of material participation by a retired spouse with active management by the surviving spouse to qualify property for current use valuation in the surviving spouse's estate where the spouse survives the first decedent by fewer than eight years.

The bill clarifies that the only retroactive amendment made by ERTA with respect to the rules on cessation of qualified use is the provision of section 2032(A)(c)(7)(A) permitting a qualified heir a 2-year grace period to begin using the property in a qualified case. The special rules on active management by certain surviving spouses apply only to estates of decedents dying after December 31, 1981.

The bill clarifies that the period to reinstate (or make) current use valuation elections by reason of the retroactive amendments in no event expired before the close of February 16, 1982.

The bill clarifies that the right to make a late initial election or reinstate a previously revoked or disallowed election is available only if one of ERTA's four retroactive amendments applies to the estate.

The bill clarifies that recapture on certain tax-free exchange occurs only to the extent nonqualified replacement property is received.

The bill provides that, if specially valued property is acquired in a transaction to which section 1040 applies (i.e., in satisfaction of a pecuniary bequest or by purchase from the decedent's estate) and is then sold to another qualified heir within one year of the decedent's death, the property will meet the holding period for long-term capital gain treatment.

Effective date

The provisions apply as if they had been included in the amendments to the current use valuation provision made by ERTA.

3. Installment payment of estate tax (sec. 104(c) of the bill and sec. 6166 of the Code)

Present law

ERTA combined the prior Code provisions which permitted an estate to make installment payments of estate taxes attributable to interests in closely held business into a single provision (sec. 6166). Under the Act, if the value of an interest in a closely held business exceeds 35 percent of the value of the adjusted gross intake, the estate tax attributable to the value of that interest may be paid in installments for up to 14 years. Unpaid installments are accelerated if certain dispositions of, or withdrawals of funds from, the business occur.

Explanation of provision

The bill corrects an erroneous reference to the percentage requirement for qualification under section 6166 and makes conforming amendments relating to the relationships between acceleration of the tax and section 303 redemptions. The bill clarifies that stock redeemed under section 303 shall not be taken into account in measuring whether an acceleration of payment is required as a result of funds being withdrawn from the business or stock having been disposed of.

Effective date

The provision applies to estates of decedents dying after December 31, 1981.

4. Transfers made within three years of death (sec. 104(d) of the bill and sec. 2035 of the Code)

Present law

Prior to ERTA, gifts made by the decedent within 3 years of death generally were includible in the decedent's gross estate (sec. 2035(a)). ERTA provided, generally, that gifts made by the decedent prior to death are not included in the decedent's gross estate. However, the Act contained exceptions which continue the application of the three-year rule to interests in property included in the value of the gross estate pursuant to section 2036, 2037, 2038, 2041 or 2042.

The Act also included transfers made within three years of death in the estate for purposes of determining eligibility for special redemptions (sec. 303), valuation (sec. 2032A), and installment payment purposes (sec. 6166).

Explanation of provision

The bill clarifies that the special 3-year rule applies for purposes of section 6166 only to determine eligibility for the installment payment provision. Under the bill, an estate will be treated as meeting the 35 percent of adjusted gross estate test of section 6166 only if the estate meets the test both with and without the application of the three-year inclusion rule of section 2035(a).

The bill applies the 3-year inclusion rule to interests which would have been includible in the decedent's estate under section

2036, 2037, or 2038, whether or not a gift tax return was required with respect to the transfer.

The bill makes the 3-year rule inapplicable to exercises of general powers of appointment (sec. 2041).

The bill allows the executor of a decedent's estate to make an irrevocable election to have the estate and gift tax amendments made by ERTA not apply in any case where the decedent made a gift before August 13, 1981, and within 3 years of death, on which a gift tax had been paid before April 16, 1982.

Effective date

The provision applies to estates of decedents dying after December 31, 1981.

5. Clerical amendments to the estate and gift tax provisions

a. The bill provides that the amendments made by ERTA section 403(d)(3)(B) are amendments to chapter 12 of the Code.

b. Code section 2523(f) is amended to refer to "rules similar to" certain rules.

c. A cross reference to Code section 2207(A) is added to section 2519.

d. A reference in Code section 2035(b) to section 6019(2) is corrected.

e. A reference in Code section 2032A(i) to a nonexistent paragraph is deleted.

f. Code section 1040 is amended by inserting "transfer" for "exchange".

g. Code section 2518(c)(3) is amended by deleting redundant language.

E. Amendments Relating to Tax Straddle Provisions

1. Postponement of recognition of certain straddle losses (sec. 105(a) of the bill and sec. 1092 of the Code)

Present law

ERTA requires the deferral of losses from positions constituting part of a straddle where there are unrealized gains on offsetting positions (sec. 1092(a)(1)). Unrealized gains on offsetting positions are defined as gains which would be taken into account if the positions were sold on the last day of the taxable year at their fair market value (sec. 1092(a)(3)(A)). Under tax accounting rules, gains from sales of property by a taxpayer on the cash method of accounting are not taken into account until the sale proceeds are actually or constructively received. In the case of year-end sales, consummation of the sales contract and receipt of the sales proceeds may not take place until the following year. Losses, however, are generally taken into account for tax purposes on the date the sales contract is executed. Prior to ERTA, these tax accounting rules permitted losses to be taken into account in one year and offsetting gains to be deferred into the following year in some cases. ERTA was intended to preclude this possibility.

Explanation of provision

The bill clarifies that the loss deferral rules of section 1092 will apply where there is unrecognized gain on offsetting positions, whether or not the gain is realized.

The bill deletes certain language of sections 1092(a)(1)(A) and 1092(d)(4) as redundant.

Effective date

The provision generally applies to property acquired after June 23, 1981.

2. Regulated futures contracts (sec. 105(c) of the bill and sec. 1256 of the Code)

Present law

In general.—ERTA adopted the market to market system of domestic exchanges to determine the tax consequences of holding regulated futures contracts (sec. 1256). Gains and losses reflected in such contracts held by the taxpayer at the close of his or her taxable year and which constitute capital assets are treated as short-term gain or loss to the extent of 40 percent of gains and losses and as long-term gain or loss to the extent of 60 percent of gains and losses. Section 1256(c) requires gains and losses to be taken into account at other relevant dates during the taxable year, such as the date a contract is closed by making or taking delivery under a regulated futures contract.

Holding period.—Section 1223(8) includes the period a commodity futures contract was held in determining the holding period of a commodity acquired by performance of the contract. Prior to ERTA, taking delivery under a futures contract was not a taxable event.

Mixed straddles.—Mixed straddles are straddles composed in part of regulated futures contracts and in part of other positions. Taxpayers may elect, under section 1256(d), to exclude the regulated futures contracts forming part of such straddles from the treatment provided by section 1256. Each position forming part of such a straddle must be identified as being part of such staddle before the close of the day on which it is acquired. If the regulated futures contract is acquired and identified before other positions included in such a straddle, failure to identify the subsequently acquired positions results in a failure to satisfy the definition of a mixed straddle in section 1256(d)(4).

Cash settlement contracts.—Regulated futures contracts the tax treatment of which is governed by section 1256 are defined to include only contracts that require the delivery of personal property (as defined in sec. 1092(d)(1)). Since the enactment of ERTA, the Commodity Futures Trading Commission has authorized trading in several market-to-market future contracts that call for cash settlement only and do not require the delivery of personal property.

Foreign currency contracts.—Trading in foreign currency for future delivery is conducted through regulated futures contracts, and is also conducted through contracts negotiated with any one of a number of commercial banks which comprise an informal market for such trading (bank forward contracts). Bank forward contracts differ from regulated futures contracts in that they are private contracts in which the parties remain entitled to performance from each other. They further differ from regulated futures contracts in that they do not call for daily variation margin to reflect market changes, and in that the interbank market has no mechanism for settlement terminating a taxpayer's position prior to the delivery date. Prior to ERTA, taxpayers who used both the futures exchanges and the interbank market to conduct short-term trading in foreign currency were subject to substantially comparable tax treatment for both types of contract. Although bank forward contracts differ from regulated futures contracts, the volume of trading through forward contracts in foreign currency in the interbank market is substantially greater than foreign currency trading on futures exchanges, and prices are readily available. Such contracts are economically comparable to regulated futures contracts in the same currencies and are used interchangeably with regulated futures contracts by traders.

Syndicates.—Hedging transactions are excepted from the market to market treatment of section 1256(a), as well as the rules of section 1092 and section 263(g). Certain syndicates, losses from which flow to limited partners or limited entrepreneurs, are excluded from the hedging exception (sec. 1256(e)(3)). The Treasury is authorized to determine that certain interests will not be treated as limited interests under these rules where it determines that an interest is held by an individual actively participating in management and where neither such interest nor the entity are used for tax-avoidance purposes. It is not clear whether this authority may be exercised through the promulgation of regulations or must be exercised on a case-by-case basis.

Explanation of provisions

Under the bill, the termination rules of section 1256(c) are amended in two respects. The bill requires that gains and losses be taken into account when a taxpayer's rights in a regulated futures contract are transferred by the taxpayer.[4] The bill also requires, if a straddle includes two or more regulated futures contracts, that all the contracts will be treated as terminated on the date the taxpayer takes delivery under any of such contracts. Thus section 1256(a) will apply when transfers of regulated futures contracts are made to and from partnerships and other flow-through entities, and to all regulated futures contracts constituting part or all of a straddle when the taxpayer takes delivery under any of such contracts.

The bill clarifies that the holding period rule of section 1223(8) will be inapplicable to commodities acquired through satisfaction of a regulated futures contract to which section 1256 applies.

The bill amends section 1256(d)(4) defining mixed straddles to require indentification of all positions constituting such straddle not later than the close of the day on which the first regulated futures contract forming part of the straddle is acquired. This amendment clarifies that an election as to whether section 1256 will apply to a regulated futures contract included in a mixed straddle may not be deferred beyond the date that contract is acquired. For this purpose, when a short regulated futures contract is treated as terminated on the date the taxpayer takes delivery under a long regulated futures contract (under the straddle amendment of section 1256(c)), the short position will be treated as a new regulated futures contract acquired on that date.

The bill modifies the provision that a contract must require the delivery of personal property to be considered a regulated futures contract. Cash settlement contracts which require the delivery of an amount of cash determined by reference to the value of any property or index based on that value will meet the delivery of personal property requirement. Thus such a contract which otherwise satisfies the definition of a regulated futures contract will be subject to the rules of section 1256 under the bill.

The bill treats certain foreign currency contracts as regulated futures contracts. Foreign currency contracts mean contracts traded through the interbank market that involve currencies which are also traded through regulated futures contracts. The Secretary of the Treasury is authorized to prescribe rules to determine the fair market value of any such foreign currency contract. For this purpose, any terms in a contract which preclude the determination of a readily ascertainable valuation may be disregarded.

Finally, the bill provides expressly that the Treasury may prescribe regulations to determine that interests will not be treated as held by limited partners or limited entrepreneurs in applying the syndicate rule.

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[4] This rule does not apply to the transfer of contracts of third party taxpayers between commission merchants.

Effective date

The provision generally applies to property acquired after June 23, 1981.

The amendment relating to bank forward contracts in certain foreign currencies applies to contracts entered into after May 11, 1982. The taxpayer may elect (within 90 days of enactment of the bill) to have that amendment apply to property held during 1981 and thereafter as though sections 508 and 509 (other than secs. 509(a)(3) and (4)) of ERTA applied with respect to such amendment. Alternatively, the taxpayer may elect to have such amendment apply to positions held on May 11, 1982 for taxable years ending after such date. The special deferred payment provisions of ERTA will not apply to these contracts. The House bill did not contain this election.

3. Capitalization of certain interest and carrying charges (sec. 105(b) of the bill and sec. 263(g) of the Code)

Present law

ERTA required taxpayers to capitalize certain otherwise deductible expenditures for personal property if the property is held as part or all of an offseting position belonging to a straddle. Interest on indebtedness incurred or continued to purchase or carry such property was required to be capitalized.

Explanation of provision

Under the provision, charges for the temporary use of personal property borrowed in connection with a short sale must be capitalized to the same extent that interest must be capitalized.

The House bill did not contain this provision.

Effective date

The provision is effective for property acquired, and positions established, by the taxpayer after September 22, 1982.

4. Prompt identification by dealers in securities (sec. 105(d) of the bill and sec. 1236 of the Code)

Present law

ERTA required a dealer in securities to identify a security as held for investment, and thus eligible for capital gain treatment, not later than the close of business on the day of the security's acquisition.

Explanation of provision

Under the provision, any security acquired by a dealer in connection with the exercise of an option may be treated as held for investment only if the dealer, before the close of the day on which the option was acquired, clearly identified the option on his records as held for investment.

The House bill did not contain this provision.

Effective date

The provision applies to securities acquired after September 22, 1982.

5. Clerical amendments to straddle provisions

a. Code section 6653(g) is redesignated as section 6653(f).

b. A reference in Code section 1092(c)(2) to subsection (a)(2(B) is corrected.

c. Section 509(b)(3) of ERTA is clarified.

F. Amendments Relating to Energy Provisions

1. Stripper oil (sec. 106(b) of the bill and sec. 4994 of the Code)

Present law

Under present law, exempt stripper well oil is oil which is produced by an independent producer from a stripper well property and which is attributable to an independent producer's working interest in the stripper well property. Exempt stripper well oil is exempt from the windfall profit tax. Under a limitation on certain transferred properties, the category of exempt stripper well oil does not include any oil attributable to an interest in property owned by a person other than an independent producer at any time after July 22, 1981.

Although this limitation was intended to reach only property interests transferred after July 22, 1981, a literal reading of the provision would disqualify as exempt stripper well oil any oil allocable to an interest in property which was owned, at any time after July 22, 1981, by a producer other than an independent producer, whether or not the interest was ever actually transferred.

Explanation of provision

The bill provides that, in determining whether a property interest was owned by a person other than an independent producer at any time after July 22, 1981, the current producer will not be considered. Thus, if the current producer of oil otherwise qualifying as exempt stripper well oil ceases to qualify as an independent producer, its production for the quarter or quarters that the producer doesn't qualify as an independent producer will not be eligible for exemption. However, if the producer later returns to independent producer status, its otherwise qualified production could then again qualify for the exemption. In such a case, if the property interest is later transferred, production from the transferred property could not qualify for the exemption even if the transferee were an independent producer because the interest would have been owned by a person (other than the producer) who at some time after July 22, 1981, and during that person's ownership of the interest, was not an independent producer.

The bill makes the further clarification that this transfer rule does not apply to the transfer of any property which was not a "proven property" within the meaning of section 613A(c)(9)(A) at the time of the transfer. For purposes of this provision, a "transfer" does not include a farm-out for development. This clarification was not included in the House bill.

Effective date

The provision applies to oil removed after December 31, 1982.

2. Qualified royalty production of trusts (sec. 106(a) of the bill and new sec. 6430 of the Code)

Present law

Under present law, qualified royalty owners are exempt from the windfall profit tax on up to two barrels a day (three barrels a day

after 1984) of production of qualified royalty oil. Only individuals estates, and qualified family farm corporations are included in the definition of qualified royalty owners. Under this rule, neither a trust nor its beneficiaries are entitled to any royalty owner exemption with respect to the production of the trust.

Explanation of provision

Under the bill, each qualified beneficiary of a trust that has qualified royalty production ("allocable trust production") will be entitled to an annual refund of windfall profit tax paid on his allocable share of that production subject to a limitation of two barrels a day (three barrels after 1984) on the total number of barrels of qualified royalty production with respect to which any beneficiary may claim either an exemption under section 4991(b)(5) or a refund under the new provision. When total production exceeds this limitation, the beneficiary may designate the amount of oil to be exempt under section 4991(b)(5). A qualified beneficiary is an individual or estate. A beneficiary's allocable share of the tax paid with respect to allocable trust production is the portion of such production which bears the same ratio to all such production as the beneficiary's allocation depletion deduction under section 611(a) bears to the entire depletion deduction allocable to the trust or its beneficiaries under section 611(b)(3). All depletion deductions allocated under section 611(b)(3) is taken into account for this purpose including depletion on hard mineral, gas, and crude oil that is not royalty production.

Allocable trust production is, with respect to any trust, taxable crude oil which is attributable to an economic interest of such trust other than an operating mineral interest (within the meaning of sec. 614(d)). Allocable trust production does not include crude oil attributable to any overriding royalty interest, production payment, net profits interest, or similar interest of the trust which was created after June 9, 1981, out of an operating mineral interest in property which is proven oil or gas property on the date such interest is created, and was not created pursuant to a binding contract entered into prior to June 10, 1981. In addition, allocable trust production does not include production attributable to an interest in any property if that interest has been transferred after June 9, 1981, in a transfer that would result in the loss of percentage depletion to the transferee under section 613A(c)(9). For this purpose, transfers include changes in the beneficiaries of the trust. The anti-transfer rules do not apply when the transferor and transferee are subject to a single limit on the amount of any refund.

Beneficiaries are subject to a single overall two barrel (three barrels after 1984) limitation on the number of barrels exempt under section 4991(b)(5) or taken into account for this refund, if they are members of the same family (defined as husband, wife, and minor child).

A trust that has allocable trust production may not reduce the amount of withholding to reflect the refund available to its beneficiaries. However, in an appropriate case, the beneficiaries could adjust their estimated tax payments to the extent that the Treasury so provides under the amendments made in section 201(j) of the bill (item 13, above).

These provisions were not in the House bill.

Effective date

This provision applies with respect to crude oil removed from the premises after December 31, 1981.

3. Clerical amendments to the energy provisions

a. Code section 6429(d)(3) is amended by striking out subparagraph (D).

b. A reference in Code section 4994(f)(3)(B) is corrected.

c. The definition of "qualified family farm corporation" in section 4994(d)(4)(B) is corrected.

G. Amendments Relating to Administrative Provisions

1. Penalty for valuation overstatements (sec. 107(a) of the bill and sec. 6659 of the Code)

Present law

ERTA added a valuation overstatement penalty that applies if the value of any property, or the adjusted basis of any property, claimed on a return exceeds 150 percent of the amount determined to be the correct valuation or basis. A $1,000 de minimis underpayment exception applies.

Explanation of provision

The bill clarifies that the $1,000 de minimis exception to the valuation overstatement penalty applies to the aggregate of all overstatements of the taxpayer for the taxable year. Also, a clarification is made that the penalty applies where the stated value is exactly 150 percent of the actual value.

Effective date

The provision applies with respect to returns filed after December 31, 1981.

2. Negligence penalty (sec. 107(a)(3) of the bill and sec. 6653 of the Code)

Present law

ERTA imposed an additional negligence penalty equal to 50 percent of the interest with respect to that portion of an underpayment which is attributable to negligence or intentional disregard of rules or regulations. The penalty is applied for the period beginning with the due date (without extensions) of the return and ending on the date of assessment of the tax.

Explanation of provision

The bill clarifies that the penalty will not apply for any period after the date payment is made (even though the tax was not assessed on or before that date).

Effective date

The provision applies to taxes the last date for payment of which is after December 31, 1981.

3. Individual estimated tax payments (sec. 107(c) of the bill and sec. 6654 of the Code)

Present law

ERTA provided that an individual is not subject to a penalty for failure to pay estimated taxes if the tax due is less than $500 (in 1985 and thereafter). (This amount is phased-up in $100 increments beginning with $100 in 1981).

Explanation of provision

The bill clarifies that the estimated tax penalty does not apply if the tax liability reduced by an income tax withheld is less than the specified amounts ($500 in 1985 and thereafter).

Effective date

The provision applies to taxable years beginning after December 31, 1980.

4. Clerical amendments to administrative provisions

a. A reference in Code section 5761 to section 6660 is corrected.
b. A reference to Code section 6015(c) is corrected.

H. Amendments Relating to Miscellaneous Provisions

1. Prepaid legal services (sec. 108(a) of the bill and secs. 120 and 501 of the Code)

Present law

ERTA extended, through 1984, the provisions of prior law allowing an exclusion from income for benefits provided under a qualified group legal services plan which is exempt from income tax under section 501(c)(20).

Explanation of provision

The bill clarifies that the section 501(c)(20) exemption provision, as well as the exclusion provision relating to group legal service plans, will terminate after 1984.

Effective date

The provision is effective on the date of enactment of the bill.

2. Clerical amendment to the miscellaneous provisions

Code section 4942(j)(3)(A)(i) is corrected by inserting "or" for "and".

TITLE II. TECHNICAL AMENDMENTS RELATING TO CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

1. Computation of net income limitations (sec. 201(a)(2) of the bill and sec. 4988 of the Code)

Present law

Under present law, the windfall profit on any barrel of crude oil cannot exceed 90 percent of the net income attributable to such barrel. In general, in determining the net income attributable to a barrel of crude oil, the taxable income from the property is determined as if intangible drilling and development cost expenditures had been capitalized and as if the producer had used cost depletion for all "taxable periods" during which he owned his economic interest in the property. Under present law, the term "taxable periods" is defined to mean March 1980, and each calendar quarter beginning after March 1980.

The reference to "taxable periods" in the "as if" cost depletion provision was intended to refer to all the taxable years during which the taxpayer had held the property, not just March 1980, and all the calendar quarters thereafter.

Explanation of provision

The bill clarifies the law by inserting "all taxable years" in place of "all taxable periods" in the "as if" cost depletion portion of the net income limitation provision.

Effective date

The provison applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

2. Inflation adjustments (sec. 201(b) of the bill and sec. 4989 of the Code)

Present law

Under present law, the inflation adjustment for any quarter to the base price of a barrel of crude oil is based on the difference between the GNP implicit price deflator for the second preceding quarter and such deflator for the second quarter of the 1979. The second revision of the GNP implicit price deflator is used for this purpose.

Explanation of provision

The bill clarified that the GNP deflator for the second quarter of 1979 is to be measured using the revision most consistent with the second revision of the GNP deflator for the second quarter preceding the current quarter.

Effective date

This provision applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

3. Definition of tier 2 oil (sec. 201(c) of the bill and sec. 4991 of the Code)

Present law

Under present law, tier 2 oil includes any oil from an economic interest in a National Petroleum Reserve held by the United States. Tier 2 oil was intended to include oil from an economic interest held by the United States in the Naval Petroleum Reserves at Elk Hills, California; Buena Vista, California; and Teapot Dome, Wyoming.

Explanation of provision

The bill clarifies that oil from an economic interest held by the United States in a Naval Petroleum Reserve is tier 2 oil. Crude oil production from the National Petroleum Reserve at Point Barrow, Alaska is exempt from the windfall profit tax under present law because that reserve is located north of the Arctic Circle.

Effective date

This provision applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

4. Definition of independent producer (secs. 201(d)(1) and 202(d)(2) of the bill and secs. 613A(d)(2) and 4992 of the Code)

Present law

Under present law, an independent producer for windfall profit tax purposes is any person who is not a "refiner" or "retailer." In general, a "retailer" is any person who directly or through a related person retails in excess of $5 million of oil or natural gas (excluding bulk sales of oil or natural gas to commercial or industrial users), or oil or gas products, in any taxable year. A "refiner" is any person which has refinery runs of more than 50,000 barrels of crude oil on any day in the taxable year. To determine whether a person is a "retailer' or "refiner" for windfall profit tax purposes, the income tax (depletion) definition is applied on a calendar quarter rather than a taxable year basis. Thus, the retailer test is applied by determining whether the gross receipts derived from the sale of oil, natural gas, or any product through all retail outlets of the taxpayer exceed $1,250,000 in the calendar quarter (rather than $5,000,000 in the taxable year). The refiner test is applied by determining whether the taxpayer's refinery runs exceed 50,000 barrels on any day during a calendar quarter (rather than on any day during the taxable year).

Explanation of provision

The bill provides for a calendar year determination, for windfall profit tax purposes, of whether a producer is a retailer or a refiner and, therefore, not an independent producer. Thus, for calendar year taxpayers the determination of independent producer status will be made on the same basis for windfall profit tax and income tax purposes. However, for fiscal year taxpayers, the determination

will be made on a calendar year basis for windfall profit tax purposes and a taxable year basis for income tax purposes.

In addition, the bill provides that, in determining the value of oil or gas products sold in any year for purposes of determining whether a taxpayer is a "retailer" (for depletion and windfall profit tax purposes), bulk sales of aviation fuels to the Department of Defense are excluded. This provision was not in the House bill.

Effective date

The provision would be effective on January 1, 1983.

5. Allocation of independent producer's qualified production (sec. 201(d)(2) of the bill and sec. 4992 of the Code)

Present law

Under present law, if an independent producer's qualified production of oil for any quarter exceeds that person's independent producer amount for that quarter (generally, 1,000 barrels a day), then that person's independent producer amount must be allocated between tiers 1 and 2 in proportion to that person's production for such quarter of domestic crude oil in each tier (and within any tier on the basis of removal price). Generally, qualified production is tier 1 or tier 2 oil which is attributable to the independent producer's working interest in the property.

The effect of this allocation provision is that when there is qualified production in excess of 1,000 barrels a day in any quarter, the 1,000 barrels must be allocated between tier 1 and tier 2 on the basis of the independent producer's total production for that quarter in either such tier, even though some of that person's tier 1 and tier 2 production includes oil which does not qualify as independent producer oil and is not, therefore, entitled to lower rates. This may occur when, for example, an independent producer also has tier 1 or tier 2 oil attributable to a royalty interest.

Explanation of provision

The bill requires that the allocation of qualified production between tier 1 and tier 2, and within any such tier, be based solely on oil which itself is qualifed production for any quarter.

Effective date

The provision applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

6. Incremental tertiary project beginning date (sec. 201(e) of the bill and sec. 4993 of the Code)

Present law

Under present law, incremental tertiary oil is treated as tier 3 oil and is, therefore, entitled to a 30-percent windfall profit rate. Incremental tertiary oil is the excess of the amount of crude oil produced and removed from a property during a month for which a qualified tertiary recovery project is in effect on the property and on or after the project beginning date (i.e., the later of certification or injection), over the base level of crude oil production from that

property during that month. To qualify as a qualified tertiary recovery project, the project must have a beginning date after May, 1979.

Explanation of provision

The bill clarifies that production from a qualified tertiary recovery project is not entitled to tier 3 treatment unless the date on which injection of tertiary injectants begins is after May 1979.

Effective date

The provision applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

7. Exempt Alaskan oil (sec. 201(f) of the bill and sec. 4994(e) of the Code)

Present law

Under present law, exempt Alaskan oil is any crude oil, other than Sadlerochit oil, which is produced (1) from a reservoir from which oil has been produced in commercial quantities through a well located north of the Arctic Circle, or (2) from a well located on the northerly side of the divide of the Alaskan-Aleutian range and at least 75 miles from the nearest point on the Trans-Alaska Pipeline System. Sadlerochit oil is crude oil produced from the Sadlerochit reservoir in Prudhoe Bay. The divide of the Alaskan-Aleutian range is that line which divides that area from which water drains into the Bering Sea (the northerly side of the divide), from that area from which water drains into the Gulf of Alaska (the southerly side of the divide).

Explanation of provision

The bill clarifies that exempt Alaskan oil include all oil produced from a well located north of the Arctic Circle (other than Sadlerochit oil) from a reservoir from which commercial quantities of oil have been produced through such well. The bill also makes a clerical amendment by changing the term "Alaskan-Aleutian range" to "the divides of the Alaskan and Aleutian ranges".

Effective date

The provision applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

8. Definition of qualified charitable interest (sec. 201(f)(3) of the bill and sec. 4994(b) of the Code)

Present law

Under present law, an economic interest in crude oil production subject to the windfall profit tax is exempt from that tax if such interest is a "qualified charitable interest."

A qualified charitable interest is an economic interest in crude oil "held by" (1) certain qualified educational organizations, hospitals, or medical research organizations, or certain educational funding organizations; (2) qualified charitable child care facilities; or (3) a church for the benefit of any of the above organizations. In addi-

tion, a charitable interest is a qualified charitable interest only if (1) the interest were held on January 21, 1980, and at all times thereafter before the last day of the taxable period, and (2) all the proceeds from the economic interest were dedicated to the benefit of any organization described above on January 21, 1980, and at all times thereafter before the last day of the taxable period.

Thus, under present law, there is only one case in which the definition of qualified charitable interest exempts production allocable to an interest held by one organization (a church) for the benefit of a second organization (schools, hospitals, etc.).

An organization described in section 509(a)(3) is a section 501(c)(3) organization which is organized and operated exclusively for the benefit of one or more organizations described in section 509(a)(1) or 509(a)(2), which is operated, supervised, or controlled by or in connection with one or more of such organizations, and which meets certain other requirements. Organizations described in section 509(a)(3) are not private foundations.

Explanation of provision

The bill expands the definition of qualified charitable interest to exempt from the windfall profit tax production attributable to an economic interest held by an organization described in section 509(a)(3), where such organization is operated exclusively for the benefit of a school described in section 170(b)(1)(A)(ii) which is also described in section 170(c)(2), or exclusively for the benefit of a qualified charitable child care facility described in section 4994(b)(1)(A)(ii), and where such income is dedicated at all times after January 21, 1980, to the support of such an organization. However, this exemption applies only when the property interest producing the income has been held by the section 509(a)(3) organization, and all the proceeds therefrom dedicated to the school or child care facility, on January 21, 1980, and at all times thereafter before the last day of the taxable period.

Thus, for example, if a section 509(a)(3) organization held property exclusively for the benefit of an organization which was a qualified school or child care facility, or both, and if the other requirements of this provision are met, the production from that property would be exempt.

This provision was not in the House bill.

Effective date

The provision is effective as if it had been part of the Crude Oil Windfall Profit Tax Act when originally effective.

9. Withholding adjustments and deemed payment date (sec. 201(g) of the bill and sec. 4995 of the Code)

Present law

Withholding adjustments

Under present law, one method whereby the windfall profit tax is collected is through withholding by first purchasers of taxable crude oil. If the amount withheld is incorrect, an adjustment of the withholding error may be required.

Generally, the Secretary may require withholding errors to be corrected by the first purchaser through adjustments to amounts withheld from that producer on crude oil purchases during the same calendar year. However, under present law, no withholding adjustment may be required which would result in the first purchaser withholding on any payment an amount in excess of the windfall profit element of that payment or which would result in withholding adjustments being made with respect to one calendar year on payments being made in a subsequent calendar year.

The calendar year and windfall profit element restrictions on required withholding corrections were designed to protect small producers during initial implementation of the windfall profit tax. Many of these small producers are now exempt from the tax.

Deemed payment date

Under present law, the producer is deemed to have paid the amount of tax withheld from him with respect to any calendar year's production on the last day of the first February following the close of that calendar year even though the amount may have been withheld in a previous taxable year.

Explanation of provision

The bill streamlines the withholding adjustment provisions of current law by striking the windfall profit limitation on the amount which may be withheld and by granting the Secretary authority to require adjustments after the close of the calendar year of removal. It is anticipated that the Treasury will continue to place limits on how long after the original error a correction can be made so that producers will be able to finally determine their tax for the year. Finally, the bill also clarifies that the deemed payment date applies for windfall profit tax and administrative purposes only.

Effective date

The provision applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

10. Net profits interests (sec. 201(h) of the bill and sec. 4996 of the Code)

Present law

Producer

The windfall profit tax is imposed on the removal of taxable crude oil from the premises from which it was produced. Liability for the tax is imposed on the "producer." In general, the producer of crude oil is the person who holds an economic interest in the crude oil. Thus, the producer who is liable for the windfall profit tax generally is the same person who is, under the income tax laws, entitled to the allowance for depletion with respect to the crude oil produced.

One of the forms of ownership which may give rise to an economic interest in crude oil is a net profits interest. A net profits interest is an interest in gross production from a property which is

measured by the net profit which remains after the owner of the working interest has recovered the cost of exploration, development, and production. A net profits interest may arise in a variety of ways. For example, a landowner or lease holder may grant a lease or sublease and retain a right to a percentage of the net profits derived by the lessee or sublessee. A net profits interest may also be acquired by direct purchase of the interest from the owner of the working interest.

Net income limitation

Under present law, the windfall profit on any barrel of crude oil cannot exceed 90 percent of net income allocable to such barrel. The "net income" allocable to any barrel of oil is equal to the total taxable income of the property attributable to the production of taxable crude oil divided by the total number of barrels of taxable crude oil produced from the property during the taxable year. For this purpose, the taxable income from the property is determined under section 613A (relating to percentage depletion) but without regard to the deductions for depletion, the windfall profit tax, intangible drilling or development costs (except for dry hole cost), or qualified tertiary injection expense deductions, otherwise allowable, but with regard to a deemed cost depletion deduction in the usual case.

Because of the interactions between the definition of producer and the net income limitation, it is possible to design a transaction in which the owner of a working interest in proven property transfers that working interest to another party in exchange for a very large (e.g., 99 percent) net profits interest. In such a case, the new working interest owner's windfall profit tax on the production allocate to him could be limited by the net income limitation.

If all the cost borne by the new working interest owner are properly taken into account for net income limitation purposes, then his taxable windfall profit would be limited to 90 percent of the one percent of net profits that he receives in addition to the cost recovery oil.

The windfall profit tax on the retained net profits interest would be the same as the tax on that production which had existed prior to the transfer. The effect of such a transaction, of properly structured, would be to eliminate the tax on the oil which is used to pay for the cost of operating the property. Thus, the aggregate windfall profit tax from the two new interest would be less than the windfall profit tax that would have been imposed in the absence of such a transfer.

State exemption

Under present law, production allocable to the economic interest of a State or political subdivision thereof, or any agency or instrumentality of a State or political subdivision thereof, is exempt from the windfall profit tax if the net income received by such entity with respect to its economic interest is dedicated to a public purpose.

Explanation of provision

The bill would prevent the use of net profits agreements entered into after March 31, 1982, to avoid the windfall profit tax on oil which is used to finance the exploration, development and operation of the property. This would be accomplished by requiring that any cost recovery oil allocated under the net profits agreement must be allocated to the parties to the agreement in proportion to their share of the net production from the property remaining after allocation of the cost recovery oil. This allocation will be made beginning in the first taxable period with respect to which the owner or owners of the net profits interest receive a share of production remaining after cost recovery and for all taxable periods thereafter regardless of whether or not the property subsequently shows a loss.

A net profits agreement is defined as an agreement entered into (or renewed) after March 31, 1982, which provides for the sharing of part or all of the production of crude oil from a property if (1) one or more persons are reimbursed for qualified cost through the allocation of cost recovery oil and (2) one or more persons are entitled to receive a share of any production remaining after reduction for the cost recovery oil. Such an agreement would include an agreement under which the owner of a net profits interest who receives a share of the net profit is also guaranteed minimum payment in the event the net profit is less than a stated dollar amount or number of barrels.

This definition of net profits agreement is not intended to include a limited carried interest arrangement under which the carried party has the right to a specified share of the working interest after the carrying party recovers the cost of primary development (*i.e.*, after payout). In such a case, the carried party is never entitled to receive a share of the "net profits" remaining after the recovery of cost; rather, the first oil in which the carried party shares is burdened by all the cost of its own production which arises after payout.

Cost recovery oil is defined as crude oil produced from the property which is allocated to reimburse a person for amounts paid or incurred exploring for, or developing or producing oil and gas from one or more oil and gas wells on the property. These costs would include a percentage add-on to the actual out-of-pocket cost of the reimbursed party since such add-on should be considered as reimbursement for overhead or other indirect cost. The bill requires the Secretary to prescribe regulations governing the allocation of gross production and cost recovery oil between the interest owners for purposes of these rules. It is anticipated that the regulations will prevent special allocations of types of income or expenses to minimize windfall profit taxes.

In addition to amending the definition of producer in the case of a net profits agreement, the bill provides that the same allocations of cost recovery oil and a similar allocation of the underlying cost should be made for purpose of computing the net income limitation of each of the producers participating in the net profits agreement. Thus the net income limitation treatment of depletion and intangible drilling costs, for example, will be determined in accordance

with the new allocation rules for the windfall profit tax and not under the usual income tax rules.

Effective date

The provision generally applies to agreements entered into or renewed after March 31, 1982. The bill also provides a special effective date rule for net profits interest agreements which provide that 90 percent or more of the net profit is to be received by a governmental entity or charity that is exempt from the windfall profit tax. In such cases, the new net profits agreement rule is applicable without regard to the March 31, 1982, effective date. Thus, preexisting arrangements between governmental units or charities on the one hand and private producers on the other hand, would be subject to the new rule if the exempt entity is entitled to 90 percent or more of the net profit.

11. Definition of crude oil (sec. 201(h)(2) of the bill and sec. 4996 of the Code)

Present law

The windfall profit tax is an excise tax on the removal of taxable crude oil from the premises from which it was produced. The tax is imposed upon the owner of the economic interest in the crude oil in place. Taxable crude oil is all domestic crude oil other than crude oil which is specifically exempted from the tax. The term "crude oil" is defined by reference to the June 1979 regulations of the Department of Energy. These regulations define crude oil as a mixture of hydrocarbons that existed in liquid phase in underground reservoirs and remains liquid at atmospheric pressure after passing through service separating facilities. "Crude oil" includes condensate recovered in associated or non-associated (i.e., gas) production by mechancial separators, whether located on the lease, at central field facilities or at any point at or before the inlet side of a gas processing plant and natural gas liquids treated as crude oil under the June 1979 energy regulations. The term "domestic' refers to crude oil produced from an oil well located in the United States or a possession of the United States.

Explanation of provision

The bill modifies two provisions in the windfall profit tax to clarify the treatment of condensate which is recovered from natural gas after the natural gas has been removed from the premises from which it was produced. First, the bill modifies the concept of removal, and hence the time at which the tax on condensate is imposed. Specifically, in the case of condensate which is recovered by mechanical separation after the natural gas is removed from the premises from which it is produced (and at or before the inlet side of the gas processing plant), the time of removal would be the time at which the condensate is, in fact, recovered. This amendment does not affect the liability of the producer for the windfall profit tax on condensates; rather, it simply addresses the question of when the windfall profit tax is imposed. Similarly, no change is made in the operative definition of crude oil. Thus, condensate recovered from gas production by mechanical separators at any point

at or before the inlet side of the gas processing plan and natural gas liquids treated as crude oil under the June 1979 energy regulations remain subject to tax. Of course, if a producer is not compensated for such crude oil, the removal price will be zero and, thus, no tax will be imposed. Similarly, if a gas stream is introduced directly into a gas processing plant so that no condensate is recovered no tax will be due because there will be no crude oil within the meaning of the June 1979 energy regulations.

Present law requires the first purchaser of domestic crude oil to withhold the windfall profit tax from amounts paid to the producer unless the Secretary provides an exception to this obligation. The Secretary may wish to modify the present withholding regulations to reflect this change with respect to the time of removal of condensate recovered off the premises. For example, a gas processing plant operator may recover condensate at the inlet side of the gas processing plant under a contract which allocates a portion of the condensate recovered to the gas processor as compensation for services and may sell that recovered condensate to a third party. The sale may be in part for the account of the producer and in part for the processors own account. In such a case, the Secretary could require withholding by the third party purchaser on the condensate sold for the account of the producer and could require the gas processor to withhold (from proceeds payable to the producer) the tax with respect to the portion of recovered condensate which he is entitled to take as compensation for his services. Only a producer who holds an economic interest in crude oil in place is liable for the windfall profit tax; thus, a pipeline or gas processor who recovers condensate produced by another will not be liable for the tax other than as a withholding agent with respect to the tax owed by the producer.

The bill provides that no withholding of windfall profit tax will be required with respect to condensate recovered off the premises prior to the publication of regulations pursuant to the amendment made by the bill. However, the producer will remain liable for the tax on the crude oil.

The second modification made by the bill is to strike the word "oil" from the definition of domestic so that the term domestic refers to all wells whether they produce oil, gas, or some other substance. By making this amendment, the committee does not intend to imply that it found merit to the argument advanced by some tax advisors that condensate produced from "gas" wells was not subject to the windfall profit tax.

The committee has not included in the bill any provision directly addressing the computation of removal price. The determination of this price will depend on the facts and circumstances of the particular case. Since the removal price is generally determined on the same basis as gross income for depletion purposes, it generally would not include the value attributable to transportation or processing. For example, if the producer is not compensated for condensate recovered after gas is removed from the premises and is not compensated for the condensate content of the gas removed from the premises, then no windfall profit tax will be imposed on the producer since the removal price of the condensate will be zero. Even where the producer is compensated for the condensate con-

tent of the gas removed from the premises, there would be no windfall profit tax liability when the removal price is less than the base price for that crude oil. However, under section 4996(f) of present law, the Secretary of the Treasury has broad authority to adjust the removal price of any crude oil to clearly reflect the fair market value of the oil. Thus, if a first purchaser and producer attempted to understate the value of condensate and overstate the value of natural gas, the Secretary would have full authority to make correcting adjustments.

In any event, the committee does not believe it would be appropriate to impose a windfall profit tax on incidental liquids recovered in pipeline operations (unless such liquids or the proceeds therefrom are allocated to the producer) if the producer applied standard separation technology before delivery of the gas to the pipeline.

Effective date

The provision applies as if it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

12. Penalty for failure to make windfall profit tax returns (sec. 201(i) of the bill and sec. 4997 of the Code)

Present law

Under present law, any taxpayer liable for the windfall profit tax, any producer or purchaser of domestic crude oil, and any operator of a well from which the domestic crude oil is produced, must keep such records, make such returns, and furnish such information to the Secretary as he may by regulation prescribe. Under present law, there is no penalty which attaches to a failure to do any of these acts except that a failure to furnish a statement described in section 6050C (relating to operator's certificates, etc.), may result in a penalty of $10 for each failure to furnish a statement with the penalty for all such failures during any such calendar year not to exceed $25,000. In contrast, present law generally provides specific penalties for failures to do acts specifically required by statute. For example, failures to file information statements are provided for in section 6052.

Explanation of provision

The bill provides fixed penalties for any failure to keep such records, make such returns, and furnish such information with respect to the windfall profit tax as the Secretary may by regulation prescribe. The bill also clarilfies that the Secretary may by regulation require that certain taxpayers furnish information statements to such other persons as the Secretary may prescribe.

Effective date

This provision will be effective with respect to any return and statement the due date of which (without regard to extensions) is after the date of enactment.

13. Estimated tax (sec. 201(j) of the bill and secs. 6015, 6154, 6654, 6655 of the Code)

Present law

Under present law, both individuals and corporations must, under certain conditions, pay estimated tax. Currently, withheld windfall profit tax is not considered in the determination of the amount of estimated taxes that must be paid.

Explanation of provision

The bill provides the Secretary with discretion to allow any overpayment of the windfall profit tax to be taken into account in determining the amount of estimate tax payments. The discretion provides to the Secretary in this regard is broad. Thus, for example, the Secretary could determine that an overpayment in windfall profit tax may not be taken into account when the producer is entitled to an exemption from windfall profit tax withholding or when an overpayment is created late in the year to avoid the estimated tax penalties.

Similarly, the Secretary could provide that only current year over payments should be taken into account for estimated tax purposes so that the exceptions to the estimated tax penalties which depend on the prior year's tax liability would not be broadened by overpayments of the windfall profit tax in the prior year.

Effective date

The provision applies as it had been included in the Crude Oil Windfall Profit Tax Act of 1980.

14. Incorporation of an oil or gas property (sec. 202(d)(1) of the bill and sec. 613A of the Code)

Present law

Under present law, average daily oil (or equivalent gas) production of up to 1,000 barrels by independent producers and certain royalty owners is entitled to percentage depletion treatment. This 1,000 barrel amount is not available with respect to any proven property which is transferred after 1974, except for transfers at death and certain transfers where the 1,000 barrels must be allocated between the transferor and the transferee.

The anti-transfer rules do not apply in the case of certain transfers by an individual of oil or gas properties (and up to $1,000 cash) to a corporation if all the stock of the corporation is issued to individuals solely for oil and gas property (and up to $1,000 cash). In such a case, additional rules apply to prevent the proliferation of interests entitled to percentage depletion through the use of the resulting corporation. These rules require allocation of the 1,000 barrel amount between related parties and prohibit certain stock transfers. Similar rules apply for windfall profit tax purposes. The term "oil or gas property" includes only interests in oil or gas in place and not associated production equipment.

Explanation of provision

The bill expands the term "oil or gas property" to include necessary production equipment associated with an oil or gas property which is in place when the property is transferred. The term "necessary production equipment" includes, for example, the "christmas tree", casing, pump jacks, on-site separator and other equipment essential for the efficient and effective production of oil and gas from a property.

Effective date

This provision will be effective with respect to transfers in taxable years ending after December 31, 1974, but only for purposes of applying section 613A to periods after December 31, 1979.

15. Alcohol fuel denaturant amendment (sec. 202(e) of the bill and sec. 44E of the Code)

Present law

Under present law, to be eligible for the gas exemption from the motor fuel excise tax, the fuel mixture must contain at least 10 percent alcohol. The Windfall Profit Tax Act authorizes the use of gasoline as an alcohol denaturant and when so used the gasoline becomes part of alcohol volume. This and all of the other alcohol fuel provisions in the Windfall Profit Tax Act became effective on October 1, 1980.

Explanation of provision

The provision permits the use of gasoline as a denaturant as of the effective date of the Windfall Profit Tax Act. The gasoline so used becomes part of the alcohol volume will be considered alcohol for purposes of the credit. This provision was not in the House bill.

The committee also notes that there have been several instances brought to its attention where the Internal Revenue Service is apparently seeking to enforce the 10 percent alcohol requirement in a rigid manner. The committee believes that this requirement should be enforced in a reasonable manner which recognizes commercial and operational practicalities. For example, in instances where the volume of fuel actually delivered is subsequently billed on temperature adjusted basis, the Internal Revenue Service should enforce the provision on the basis of the volume of the fuel actually delivered. Similarly, the Internal Revenue Service should apply the 10 percent requirement with some tolerance of the operating realities of the industry.

Effective date

This provision is effective as if enacted as part of the Crude Oil Windfall Profit Tax Act as originally enacted.

16. Business energy credits for certain long-term projects (sec. 202(f) of the bill and sec. 46(a)(2)(iii)(I) of the Code)

Present law

Under present law, certain business energy credits expire at the end of 1982. However, under an affirmative commitment rule for

long-term projects, these expiring credits continue to apply through 1990 if (1) before 1983 the taxpayer has completed all engineering studies and applied for all environmental and construction permits, and (2) before 1986 the taxpayer has entered into binding contracts for the acquisition or construction of a certain portion of the equipment specially designed for the project.

Explanation of provision

The bill clarifies that the affirmative commitment rule for long-term energy projects may apply even if someone other than the taxpayer obtains the permits and completes the studies by January 1, 1983. However, as under present law, the taxpayer and no other person must enter into binding contracts for a certain portion of the project by 1986. This provision is not contained in the House bill.

Effective date

The provision applies as if enacted as part of the Crude Oil Windfall Profit Tax Act as orginally enacted.

17. Clerical amendments

a. Code section 4988(b)(3) is amended by striking out "purposes of paragraph 2" and inserting in lieu thereof "purposes of this subsection."

b. Code section 4992(d)(3)(B)(i) is amended by striking out "has the property" and inserting in lieu thereof "has the interest."

c. Section 4994(c)(2)(A) is amended by striking out "the taxpayer" each place it appears and inserting in lieu thereof "the producer".

d. Section 44(D)(f) is amended by striking "December 3, 1979" each place it appears and inserting in lieu thereof "December 31, 1979."

e. Section 193(b)(1) is amended by striking out "during the taxable year."

f. Section 223(a)(1) of the Crude Oil Windfall Profit Tax Act of 1980 is amended by striking out "paragraph 10" and inserting in lieu thereof "subparagraph (A), paragraph (10)."

Effective date

These provisions apply as if they had been included in the Crude Oil Windfall Profit Tax Act of 1980.

TITLE III.—TECHNICAL CORRECTIONS TO THE INSTALLMENT SALES REVISION ACT OF 1980, ETC.

1. Sales of depreciable property between related parties (sec. 301 of the bill and sec. 1239 of the Code)

Present law

The Installment Sales Revision Act of 1980 provides that sales or exchanges of depreciable property between certain related parties are denied both capital gains treatment (sec. 1239) and installment sales reporting (sec. 453(g)). Related parties include a husband and wife, a taxpayer and a corporation or partnership which is 80-percent owned by the taxpayer, or two entities (corporations or partnerships) each of which is 80-percent owned by a person. Stock or

partnership interests held by one spouse are treated as also held by the other spouse.

Under the Act, because of the application of "back attribution" rules, two entities could be treated as related even though there is no common 80-percent owner of the entities. For example, if Corporation X is owned 100 percent by A and Corporation Y is a publicly traded corporation in which A owns one share of stock, X and Y would be treated as related, since Y would be treated as owning 100 percent of X through "back attribution" of A's ownership of X.

Explanation of provision

The bill corrects the application of "back attribution" constructive ownership rules under section 1239 for cases where the entities are not considered 80-percent owned by the same person. Thus, in the case of commonly-owned corporations, if no one person owns, directly or indirectly, 80 percent or more of the stock of both corporations, the corporations will not be subject to the ordinary income rules of section 1239 with respect to any sale of depreciable property between them. For example, if Corporation X is owned 100 percent by A, and Corporation Y is owned 79 percent by A and 21 percent by a person unrelated to A, then X and Y will not be treated as related parties for purposes of section 1239. However, if A owns 81 percent of the Corporation Y stock, section 1239 will continue to apply, since both corporations are 80-percent owned entities with respect to A.

Under the bill, if Corporation X owns at least 80 percent (by value) of the stock of Corporation Y, the corporations are related parties and section 1239(a) will continue to apply to sales of depreciable property between them. If the corporations file a consolidated return, the rules applicable to sales between X and Y will continue to be governed by the consolidated return regulations (Reg. § 1.1502-13).

Effective date

The provision applies to sales or exchanges made after October 19, 1980.

2. Receipt of like-kind property (sec. 303 of the bill and sec. 453(f) of the Code)

Present law

The Act provided that property permitted to be received without recognition of gain in certain like-kind exchanges would not be treated as a payment for purposes of reporting income under the installment method.

Explanation of provision

The bill clarifies that receipt of like-kind property will qualify as a "payment" for purposes of determining whether a transaction is an installment sale.

Effective date

The provision applies to sales or exchanges made after October 19, 1980.

3. Clerical amendment to the Installment Sales Revision Act

A reference of Code section 453B(d)(2) to section 453B(a) is corrected.

4. Technical corrections to the Bankruptcy Tax Act of 1980 (sec. 304 of the bill and secs. 368 and 443 of the Code)

a. A cross reference in section 443 to section 1398(d)(2)(E) is corrected.

b. A meaningless reference to "stock" in section 368(a)(2)(C) is deleted.

c. A clarification is made that transfers to a corporation in a bankruptcy proceeding, as well as transfers from a corporation in such a proceeding, may qualify as a tax-free reorganization under section 368(a)(1)(G).

d. It is clarified that the disposition of stock by certain former creditors will not result in income being recognized to the extent the transfer qualifies as tax-free under section 354, 355, or 356.

5. Miscellaneous amendments (sec. 305 of the bill)

a. A clerical amendment to the definition of "open year" in the effective date of Public Law 96–603 is made.

b. Section 194, relating to employer liability trusts, is redesignated as section 194A.

6. Provisions relating to members of the Armed Forces missing in action (sec. 307 of the bill and secs. 2, 692, 6013, and 7508 of the Code)

Present law

Under present law, certain special rules are provided for servicemen in missing in action status from the Vietnam conflict and the spouses of these servicemen. These rules include the right of the spouse to file a joint return (or a return as a surviving spouse after it is determined that the missing individual died), the right to have the due date for filing returns and paying taxes postponed, and the forgiveness of taxes of persons who died while in military service. These special rules specifically expired for those whose determination of death had not been made as of January, 1978.

Explanation of provision

The special rules relating to servicemen missing in action from the Vietnam conflict are extended to those whose determination of death is made by the end of 1982. The House bill did not contain this provision.

Effective date

The provision will be effective on enactment.

7. Corporate aquisitions (sec. 306(a)(4) of the bill and sec. 338 of the Code)

Present law

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) provided that certain stock purchases by a corporation could be

treated as a purchase of assets of the target corporation. The provision was made retroactive on an elective basis for stock acquisitions made after August 31, 1980, and before September 1, 1982, where the target corporation had not been liquidated by September 1, 1982.

Explanation of provision

The bill provides special rules for elections with respect to stock acquisitions before September 1, 1982. Under the bill, the date on which the election is made will be treated as the date on which the target corporation's assets are deemed to be purchased. Thus, adjustments must be made for distributions and other items attributable to operations of the target company between the actual acquisition date and the date of election, analogous to adjustments required by the last sentence of section 334(b)(2) as in effect prior to TEFRA. The rules requiring consistency of treatment where several acquisitions are made from the same affiliated group will not apply. An election made before September 28, 1982, may be revoked on or before November 15, 1982. Under these special rules, the period within which the maximum percentage ownership of the target corporation's stock by the purchasing corporation will be determined for limiting nonrecognition of gain or loss under section 337 will be measured from the date the election is made rather than the actual acquisition date. The House bill did not contain this provision.

Effective date

The provision is effective for certain acquisitions made after August 31, 1980, and before September 1, 1982.

8. Partial liquidation effective date (sec. 306(a)(3) of the bill and sec. 346 of the Code)

Present law

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) repealed the prior law partial liquidation rules for corporate shareholders. Transitional rules were provided for certain transactions where acquisitions were made during the first part of 1982.

Explanation of provision

The bill provides that the transitional rule (TEFRA sec. 222(f)(2)(C)) will apply where control was acquired indirectly through another corporation. Thus, where control of parent corporations was acquired in 1982 prior to July 23, and a plan of partial liquidation of a second tier subsidiary into a first tier subsidiary of the parent corporation is adopted before October 1, 1982, the new provisions will not apply to the liquidation. The House bill did not contain this provision.

Effective date

The provision will be effective on the date of enactment.

9. Extension of time of payment of cigarette floor stocks tax (sec. 306(a)(8) of the bill and sec. 283(b) of TEFRA)

Present law

Under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), the excise tax on cigarettes is doubled for small cigarettes, effective January 1, 1983 (from $4 per thousand to $8 per thousand, or from 8 cents per pack to 16 cents per pact). The tax rate for large cigarettes is also doubled, from $8.40 to $16.80 per thousand.

In addition, a floor stocks tax is to be imposed on cigarettes held for sale on January 1, 1983, except that the floor stocks tax will not apply to cigarettes in retail stocks held at the place where intended to be sold at retail. The floor stocks tax is equal to the difference in the increased tax rate over the prior rate.

Generally, the floor stocks tax must be paid on or before January 18, 1983. However, the conferees on the TEFRA stated that it was intended that the Treasury Department exercise its present authority over the time and method of paying cigarette excise taxes "to permit extensions of time of up to 30 days for payment of the floor stocks tax in circumstances where the taxpayer demonstrates that financial hardship would result from payment of the tax on the date otherwise prescribed" (H.Rep. No. 97-760, at 662).

Explanation of provision

The bill provides a 30-day extension of the date for payment of the cigarette floor stocks tax under TEFRA, thus extending the date the tax is due from January 18, 1983 to February 17, 1983, because the committee believes that the Treasury Department should not be put in the position of having to determine whether a given cigarette manufacturer or wholesaler would suffer "financial hardship" from having to pay the floor stocks tax by January 18, 1983. The House bill did not contain this provision.

Effective date

The provision is effective on the date of enactment.

10. Safe harbor leasing transitional rules for turbines and boilers (sec. 306(a)(2) of the bill and sec. 208(d)(3)(E) of TEFRA)

Present law

Under the safe harbor leasing transitional rules (TEFRA sec. 208(d)(3)(E)), the modifications to safe harbor leasing do not apply in certain cases to boilers and turbines of a cooperative organization described in Code section 1381(a).

Explanation of provision

The bill clarifies that the safe harbor leasing transition rule for boilers and turbines applies only for cooperative organizations engaged in the activity of furnishing electric energy to persons in rural areas. The House bill did not contain this provision.

Effective date

The provisions apply as if they were included in section 208(d)(3) of TEFRA.

11. Safe harbor leasing transitional rules for mass commuting vehicles (sec. 306(a)(2) of the bill and sec. 208(d)(5) of TEFRA)

Present law

Closely held corporations are allowed to enter into safe harbor leases as lessors without generally having to comply with the at-risk limits on losses and credits. This rule applies to property that is subject to the safe harbor leasing transitional rules other than the transitional rule for mass commuting vehicles.

Explanation of provision

The bill clarifies that the provision allowing closely held corporations to act as lessors in safe harbor leases without having to comply with the at-risk rules applies to mass commuting vehicles that are included in the safe harbor leasing transitional rule for that property. The House bill did not contain this provision.

Effective date

The provisions apply as if they were included in section 208(d)(5) of TEFRA.

12. Clerical amendments

The bill makes clerical and correcting amendments to certain provisions of TEFRA. The House bill did not contain these provisions.

13. Technical corrections relating to spending reduction provisions of P.L. 97-248

a. Clerical amendments

Subsections (a)(1) through (a)(10), subsections (b)(1) through (b)(15), and subsections (b)(17) through (b)(23) of section 308 of the bill contain certain technical corrections including changes in cross reference, titles, grammar, typesetting, spelling, and the inclusion of certain words previously omitted.

b. Calculation of Federal Medicaid payment (sec. 308(b)(16) of the bill)

Present law

The 1981 Budget Reconciliation Act (P.L. 97-35) reduces Federal Medicaid payments to States by 3 percent in fiscal year 1982, 4 percent in fiscal year 1983, and 4.5 percent in fiscal year 1984. States can earn back the reductions if they keep their total program growth below a specified target rate (9 percent for fiscal year 1981—fiscal year 1982).

Because the target rate is specified in terms of total Federal payments rather than total expenditures, and because basic State matching rates changed between fiscal year 1981 and fiscal year 1982, States whose Federal matching rates fell could fall below the

target more easily qualifying them for incentive payments than States whose matching rates rose.

To assure that States were rewarded for controlling total program growth, as the Congress intended, rather than rewarding them for reductions in their matching payments, a technical amendment (section 137(b)(16)(E)) was added to P.L. 97-248 (TEFRA) which would use States' 1981 matching rates in making target rate determinations.

The technical amendment added to TEFRA results in reduced Federal incentive payments to several States and increased incentive payments to other States.

Explanation of provision

The bill directs that for purposes of computing the Federal share of expenditures for fiscal years 1982, 1983, and 1984, the Federal medical assistance percentage used shall be the lower of that in effect for the State in fiscal year 1981, or that in effect for fiscal year 1982.

The effect of the provision is to allow those States whose Federal medical assistance percentage decreased between fiscal year 1981 and fiscal year 1982, to receive recognition for a reduction in Federal spending that resulted from this change.

c. PSRO evaluations (sec. 308(d) of the bill)

Present law

TEFRA repeals the existing Professional Standards Review Organization (PSRO) program and requires the Secretary to enter into contracts for utilization and quality control peer review. The Secretary is also required to consolidate geographic areas previously established for PSROs.

TEFRA requires the Secretary to enter into contracts with peer review organizations for each geographical area if a qualified organization is available and the organization and the Secretary negotiate a proposed contract which the Secretary determines will be carried out in a manner consistent with the efficient and effective administration of the provisions of part B of Title XI of the Social Security Act.

Explanation of provision

The bill conveys the committee's intention that existing PSROs compete on an equal footing during contract negotiations under the peer review system authorized by TEFRA and that their contract proposals be considered based on a fair evaluation of efficiency and effectiveness.

The committee has taken note of the results of a recent GAO report dealing with the 1982 PSRO evaluations being conducted by the Health Care Financing Administration (HCFA). The report is particularly critical of the HCFA evaluation, as it was performed in the first and second quarters of 1982.

GAO found that the evaluation criteria and scoring levels used by HCFA were revised with the objective of terminating a predetermined number of PSROs without regard for their effectiveness; that the evaluation methodology used by HCFA places those

PSROs reviewed in the early quarters of 1982 at a relative disadvantage in the evaluation process; and that a number of errors were found in the scores given to several PSROs. The committee finds the points made in this GAO report to be persuasive, and the committee concurs with GAO when it concludes that HCFA's evaluations of PSROs that were performed in the first two quarters of 1982 do not provide a sound basis for determining the effectiveness of PSROs. For these reasons, the committee proposes to instruct the Secretary to disregard the results of the first two quarters of the 1982 evaluation as he chooses among those organizations competing for contracts under the new peer review system.

d. Hospice Care (sec. 308(e) of the bill)

Present law

Under the hospice benefit provisions of TEFRA, a participating hospice is required to provide certain services directly. These "core" services include nursing, medical social services, physicians' services, and counseling. Physical therapy, home health aid and homemaker services, and other hospice services could be furnished through arrangements made by the hospice with other parties.

TEFRA also requires the Secretary to continue the existing Health Care Financing Administration's hospice demonstration projects until the effective date of the hospice benefit.

Explanation of provision

The provision would permit the Secretary to continue a specific hospice demonstration project until September 30, 1986 even though the hospice involved does not provide hospice care directly but acts as a channeling agency for the provision of hospice care. However, if such a hospice is continued they would be subject to the same requirements as those imposed on all other hospices, other than the requirement that certain benefits be provided directly by the hospice involved.

e. Federal supplemental compensation program (sec. 309 of the bill)

Present law

Title VI of TEFRA provided for the establishment of a Federal Supplemental Compensation (FSC) program. Section 602(e) of that title provides that each State shall establish, for each eligible individual applying for FSC benefits, an FSC account in the amount of 6, 8, or 10 weeks of benefits, whichever duration is the maximum applicable in that State.

Explanation of provision

The bill clarifies the availability of benefits to an individual filing an interstate claim for FSC benefits. As is the practice for the Extended Benefits (EB) program, the duration of the individual's FSC entitlement may be modified on the basis of whether the individual is filing his claim on an intrastate or interstate basis. Under this provision, the maximum amount of Federal supplemental compensation payable to any individual filing an interstate

claim shall not exceed the lesser of the number of weeks available in the State in which the individual is filing for benefits or the State that is liable for payments of his claim.

f. Effective Date

These provisions (items a—e) are effective as if originally included in P.L. 97-248 (TEFRA). Any amendments made to the Social Security Act by this bill are effective as if originally included in the provisions of the Act which were amended or added by P.L. 97-248.

III. COSTS OF CARRYING OUT THE BILL AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

Budget Effects

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the budget effects of H.R. 6056, as reported.

Budget receipts

It is estimated that most of the provisions contained in the bill have no effect on budget receipts. While certain individual provisions may appear to result in a minor increase or decrease in revenues, those revenue effects were taken into account in estimating the revenue effects of the original bills. Two of the amendments to the bill adopted by the committee do have revenue impact, and their estimated effect on budget receipts is shown below.

[In fiscal years and millions of dollars]

	1983	1984	1985	1986	1987
Rehabilitation expenditures (sec. 102(f) of the bill)	(1)				
Qualified royalty production of trusts (sec. 106 (a) of the bill)	−42	−51	−49	−49	−48
Definition of independent producer (secs. 201 (d) (1) and 202(d) (2) of the bill)	(1)	(1)	(1)	(1)	(1)
Total [2]	−48	−54	−52	−52	−51

[1] Loss of less than $5 million.

[2] For budget scorekeeping purposes, the totals include $3 million for each item as "less than $5 million."

Budget outlays

It is estimated that section 308 of the bill (calculation of Federal Medicaid payments) will increase budget outlays by $6 million in

fiscal year 1983, by $7 million in fiscal year 1984, and no effect thereafter.

Vote of the Committee

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the vote by the committee on the motion to report the bill. H.R. 6056, as amended, was ordered favorably reported by voice vote.

IV. REGULATORY IMPACT OF THE BILL AND OTHER MATTERS TO BE DISCUSSED UNDER SENATE RULES

A. Regulatory Impact

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of this bill.

Numbers of individuals and businesses who would be regulated

The bill does not involve new or expanded regulation of individuals or businesses.

Economic impact of regulation on individuals, consumers, and business

The bill will make it easier for affected persons to understand and comply with the statutory changes made by the Economic Recovery Tax Act of 1981 and certain other tax legislation.

Impact on personal privacy

The bill does not relate to the personal privacy of individuals.

Determination of the amount of paperwork

The bill will involve little, if any, additional paperwork for taxpayers. It will reduce the uncertainties and paperwork for some persons affected by the statutory changes made by the Economic Recovery Tax Act of 1981 and certain other tax legislation.

B. Other Matters

Consultation with Congressional Budget Office on budget estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates of the tax provisions of the bill (as shown in Section III of this report) and agrees with the methodology used and the committee's budget estimates.

New budget authority

In compliance with section 308(a)(1) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by section 308 (relating to computation of Medicaid payments) the bill involve new budget authority of $6 million for fiscal year 1983 and $7 million for fiscal year 1984.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act with respect to tax expenditures, and after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by the bill involve no new or increased tax expenditures.

V. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the provisions of H.R. 6056, as reported by the committee).

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